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No. 87-___

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT

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QUESTIONS PRESENTED

1. Whether a $5,000,000 punitive damage award, imposed for conduct punishable by no more than a $500 fine if sanctioned administratively by the State, is excessive in violation of the Excessive Fines Clause of the Eighth Amendment.

2. Whether the Due Process Clause of the Fourteenth Amendment prohibits the imposition of a $5,000,000 punitive damage award pursuant to a newly formulated legal standard that did not exist and to which the defendant could not reasonably have been expected to conform at the time the alleged wrongful conduct occurred.

3. Whether defendants in civil actions in which punitive damages may be imposed are entitled under the Due Process Clause of the Fourteenth Amendment to some or all of the same procedural rights as are enjoyed by defendants in criminal cases.*

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* All parties to this case are named in the caption. Pursuant to Rule 28.1 of the Rules of the Court, the following constitutes a list of all parent companies, non-wholly owned subsidiaries, and affiliates of petitioner: The Ohio Casualty Insurance Company is the wholly owned subsidiary of Ohio Casualty Corporation; The Ohio Casualty Insurance Company has a controlling interest in, but does not wholly own, the West American Insurance Company of Anaheim and the Ohio Security Insurance Company of Hamilton, Ohio.

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Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF CALIFORNIA, SECOND APPELLATE DISTRICT

The Ohio Casualty Insurance Company ("Ohio") respectfully petitions this Court to issue a Writ of Certiorari to the Court of Appeal of California, Second Appellate District, to review three questions raised by that court's affirmance of a $5,000,000 punitive damage award against petitioner. Question 1, pertaining to the excessiveness of this award, is presently before this Court in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987). Question 2, pertaining to the imposition of punitive damages on the basis of a newly formulated legal standard, and Question 3, pertaining to the lack of procedural protection accorded defendants in civil actions who are exposed to punishment in the form of punitive damages, raise important issues implicat-

ing the manner in which punitive damages are imposed in civil litigation throughout the United States.

OPINIONS BELOW

The February 26, 1987 opinion of the California Court of Appeal, Second Appellate District, is reported at 189 Cal. App. 3d 1072 and 234 Cal. Rptr. 835, and is reproduced in Appendix A, *infra*. The order entered by that court on March 17, 1987 denying petitioner's Petition for Rehearing is unreported and is reproduced in Appendix B, *infra*. The Notice of Entry of Judgment by the Superior Court of California for the County of Los Angeles on January 12, 1984 is unreported and is reproduced in Appendix C, *infra*. The May 27, 1987 order of the Supreme Court of California denying petitioner's Petition for Review is unreported and is reproduced in Appendix D, *infra*.

JURISDICTION

The Court of Appeal rendered its decision affirming the trial court's judgment against petitioner on February 26, 1987. In its decision, the Court of Appeal decided adversely to petitioner Questions 1 and 3 presented herein. That court also decided points of state law that gave rise to Question 2 presented herein, which is timely raised in this Court, *see* note 6, *infra*. The Court of Appeal denied petitioner's timely Petition for Rehearing on March 26, 1987. The Supreme Court of California denied petitioner's Petition for Review on May 29, 1987. This Petition is being filed within ninety days of the denial of review by the Supreme Court of California. Petitioner

invokes the jurisdiction of this Court pursuant to 28 U.S.C. § 1257(3).

CONSTITUTIONAL PROVISIONS INVOLVED

1. The Excessive Fines Clause of the Eighth Amendment provides, in pertinent part:

> "[N]or [shall] excessive fines [be] imposed . . . ."

2. The Due Process Clause of the Fourteenth Amendment provides, in pertinent part:

> "[N]or shall any State deprive any person of . . . property, without due process of law . . . ."

STATEMENT OF THE CASE

So far as petitioner is aware, the $5,000,000 punitive damage award in this case is the largest ever affirmed by the appellate courts of California and the largest ever finally affirmed in any jurisdiction in an insurance bad faith case.[1] This case presents the question whether punitive damage awards imposed in civil

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[1] Among reported cases, the next highest punitive damage award in an insurance bad faith case sustained by the highest court of a state would appear to be the $3,500,000 award at issue in *Allstate Insurance Co.* v. *Hawkins*, 733 P.2d 1073 (Ariz. 1987), *pet. for cert. filed* July 6, 1987 (No. 87-40). The Supreme Court of Alabama initially sustained the $3,500,000 award in *Aetna Life Insurance Co.* v. *Lavoie*, 470 So.2d 1060 (Ala. 1984), but on rehearing after this Court vacated that judgment, *Aetna Life Insurance Co.* v. *Lavoie*, No. 84-1601 (Apr. 22, 1986), 106 S. Ct. 1580 (1986), the punitive damage award was remitted to $500,000. *Aetna Life Insurance Co.* v. *Lavoie*, 505 So.2d 1050 (Ala. 1987).

litigation, awards which serve the same purposes as fines imposed in criminal cases—punishment and deterrence, are subject to the restraints of the Excessive Fines Clause of the Eighth Amendment and the Due Process Clause of the Fourteenth Amendment. In affirming this punitive damage award, the Court of Appeal expressly held that the Eighth Amendment "applies only to criminal actions, not to purely civil penalties, as involved here. (*Ingraham v. Wright* (1977) 430 U.S. 651, 664 . . . ." App. A, *infra*, 30a, 189 Cal. App. 3d, at 1101, 234 Cal. Rptr., at 852. The Court of Appeal also rejected petitioner's argument that it was entitled to the same procedural rights enjoyed by defendants in criminal cases, holding that "[w]here, as here, the action is civil in nature, civil rules rather than criminal rules of procedure apply." *Id.* In addition, this punitive damage award was imposed for conduct which violated a standard newly formulated and applied in the case at bar but which did not exist in California when the conduct at issue occurred. Thus, this case presents substantial and important questions regarding the extent to which the Constitution regulates the imposition by juries, operating without meaningful legal standards, of harsh, punitive monetary fines on an *ad hoc* basis in civil litigation in California and other States.

A. Statement of Facts

In February of 1973, Ohio issued a Savings and Loan Blanket Bond, or "fidelity bond," to respondent, Downey Savings and Loan Association ("Downey"). The fidelity bond contained Ohio's promise to indemnify Downey for losses incurred as a result of "any dishonest or fraudulent act" of Downey's employees. In addition, the fidelity bond provided that:

> [Ohio] will indemnify [Downey] against court costs and reasonable attorneys' fees incurred and paid by [Downey] in defending any suit or legal proceeding brought . . . to enforce [Downey's] liability or alleged liability on account of any loss, claim or damage which, if established against [Downey], would constitute a valid and collectible loss sustained by [Downey] under the terms of this bond.

[CT 7035]. As an alternative to indemnifying Downey for defense costs incurred by it, the policy gave Ohio the option "to conduct the defense of [any] suit . . . in [Downey's] name, through attorneys of [Ohio's] own selection." *Id.*

The terms of the fidelity bond further required Downey, "[a]t the earliest practicable moment after discovery of any loss," to give "written notice thereof" and "within six months after such discovery [to] furnish . . . affirmative proof of loss with full particulars." [CT 7036]. Finally, the fidelity bond provided:

> [l]egal proceedings for recovery of any loss hereunder shall not be brought prior to the expiration of sixty days after such proof of loss is filed with [Ohio] . . . except that any action or proceeding . . . to recover attorneys' fees . . . shall be begun within twenty-four months from the date upon which the judgment in such suit shall become final.

Id.

In 1974, several individuals who were not employed by Downey concocted a scheme to use bad checks to obtain certificates of deposit from Downey. These cer-

tificates were then to be pledged as bogus security for loans from a third-party lender. In the case Downey ultimately brought against Ohio to recover for its liability to the lender for the lender's losses sustained as a result of this scheme, Downey claimed coverage under the fidelity bond because of the asserted involvement in the scheme of Downey's branch manager.

The alleged participation of the branch manager was a central factual issue in the litigation against Ohio brought by Downey. Despite the branch manager's denial of participation and evidence corroborating his version of the facts, his alleged role ultimately became the basis upon which the jury determined that Ohio was liable on the fidelity bond.

The conspirators began execution of their scheme in late 1974 and early 1975 by opening accounts with Downey. Each account was opened with a bad check. The conspirators then arranged for two separate loans from the same lender, using the Downey accounts as collateral. As a condition of the loans, the lender required Downey to execute instruments acknowledging each assignment of the Downey accounts to the lender and verifying that each of the accounts was in existence and unencumbered. The acknowledgment for the first loan, in the amount of $100,000, was obtained without the involvement of the alleged dishonest branch manager, but he did execute the acknowledgment form for the second loan. The lender, noticing an irregularity in the form submitted to it, declined to make the second loan and initiated inquiries to Downey concerning the first loan.

During the balance of 1975, Downey's concern over its potential exposure to the lender relative to the

$100,000 loan was brought by Downey to the attention of Ohio. Ohio pursued an investigation of the matter, although the timing, nature and circumstances of Downey's notice to it and the adequacy of Ohio's ensuing investigation were matters of dispute during the trial of this case.

In January of 1976, the $100,000 loan went into default and the lender filed suit against Downey. Downey furnished a copy of the complaint to Ohio and requested that Ohio assume its defense. Ohio declined to assume the defense, observing that the fidelity bond provided for indemnification of fees and costs only with respect to cases involving fraud or dishonesty by a Downey employee, whereas the suit filed against Downey contained no allegations of Downey employee dishonesty.

On October 31, 1977 Downey requested indemnification from Ohio for its costs of defense and attorneys fees incurred in defending itself against the lender's claim, asserting that "Downey has just obtained information to support its contention that any loss it may incur in connection with [the lender's suit] results from dishonest or fraudulent acts committed by an employee of Downey." [CT 4929, 4932]. On November 14, 1977 Ohio rejected this request on the ground that Downey had not yet submitted adequate notice and proof of loss. [CT 4951-52].

On November 22, 1977, Downey responded by reasserting its entitlement to coverage under the fidelity bond, but stated that no proof of loss was required "since it has not yet sustained any loss except for its litigation costs . . . ." [CT 4955]. As to its litigation costs, Downey agreed that "in light of [Ohio's] refusal to conduct the defense of such litigation . . . ," "any

such claim for indemnification . . . would properly be made upon the termination of the litigation [between the lender and Downey"]. [CT 4954].

Downey filed its action against Ohio for damages for Ohio's alleged bad faith under the fidelity bond in November of 1978. Over two years later, in February of 1981, Downey settled the case against it by the lender for $55,000.

In a partial summary judgment proceeding in the bad faith case by Downey against Ohio, the trial court determined that Ohio's obligation to indemnify Downey for its defense costs arose as of October 31, 1977 because, by that date, Ohio was aware of testimony concerning "fraudulent or dishonest acts on the part of a Downey employee . . . ." [CT 2709]. The trial court expressly held that it is "irrelevant to the determination of this motion, whether [the] testimony of that witness . . . was or was not true. . . . [C]learly by this date Ohio was aware of facts claimed to exist which showed a potential liability on the part of Downey (Gray v. Zurich etc., 1966, 65 C.2d 263, 276.)" *Id.*

After trial, on January 9, 1984 the jury returned a verdict for $123,769.75 in compensatory damages (comprising $55,000 for the settlement of the case against Downey by the lender and $68,769.75 for attorneys' fees and costs incurred by Downey in defending against the lender's claim) and $5,000,000 in punitive damages, plus prejudgment interest and costs.[2] [CT 4254-55].

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[2] The Court of Appeal stated that the compensatory award was $152,983.43. App. A, *infra*, 25a, 189 Cal. App. 3d, at 1097,

B. Presentation of the Federal Questions

Petitioner appealed this judgment to the Court of Appeal, raising several state law challenges and, in addition, arguing that the $5,000,000 punitive damage award was excessive under the Excessive Fines Clause of the Eighth Amendment of the Constitution and that it was entitled under the Due Process Clause of the Fourteenth Amendment to the procedural protections enjoyed by defendants in criminal cases. On February 26, 1987 the Court of Appeal issued its decision, expressly rejecting these federal challenges and affirming the trial court's judgment.

Citing this Court's decision in *Ingraham* v. *Wright*, 430 U.S. 651, 666 (1977), the Court of Appeal held the Eighth Amendment to be inapplicable to punitive damages in civil cases. App. A., *infra*, 30a, 189 Cal. App. 3d, at 1101, 234 Cal. Rptr., at 852. The Court of Appeal likewise rejected petitioner's Due Process Clause argument, ruling that "[w]here, as here, the action is civil in nature, civil rules rather than criminal rules of procedure apply." *Id.*

The Court of Appeal upheld Ohio's liability for bad faith and punitive damages in part on the basis of Ohio's failure to pay Downey's defense costs as of October 31, 1977. In doing so, it expanded the scope of Ohio's duty to indemnify, equating it with a duty to defend. Thus, the court held that, although "Ohio had the option of defending Downey or indemnifying it for court costs and attorney's fees incurred in the defense of a third-party lawsuit," App. A, *infra*, 10a-

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234 Cal. Rptr., at 850. The jury's award was actually $123,769.75, to which the trial court added $29,213.68 in prejudgment interest.

11a, 189 Cal. App. 3d, at 1087, 234 Cal. Rptr., at 842, it was nonetheless liable under the policy for failing to pay such costs and fees as of October 31, 1977 because an insurer's obligation to defend is triggered when " 'the insurer learns . . . facts which give rise to the potential of liability under its policy.' " App. A, *infra*, 12a, 189 Cal. App. 3d, at 1088, 234 Cal. Rptr., at 843, *quoting Hartford Accident & Indemnity Co.* v. *Civil Service Employees Insurance Co.*, 33 Cal. App. 3d 26, 34, 108 Cal. Rptr. 737, 742 (1973). This holding imposed on Ohio liability for compensatory and punitive damages under a standard which did not exist in 1977 and could not have been anticipated by Ohio at that time. In fact, in 1977 the law in California was that the duty to defend was much broader than the duty to indemnify.

Petitioner renewed its arguments regarding the excessiveness of the punitive damage award and the lack of procedural protections in a Petition for Review filed in the Supreme Court of California on April 7, 1987. Petitioner also argued that the affirmance of the punitive damage award on the basis of a newly formulated legal standard violated the Due Process Clause of the Fourteenth Amendment. The Supreme Court of California denied the Petition in an order dated May 27, 1987. App. D, *infra*, 36a.

REASONS FOR GRANTING THE WRIT

The questions presented herein raise substantial and recurring issues requiring decision by the Court. Question 1, regarding the applicability of the Excessive Fines Clause to punitive damage awards, is presently before the Court in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar.

9, 1987), and has been described by the Court as raising an "important" issue which, "in an appropriate setting, must be resolved." *Aetna Life Insurance Co.* v. *Lavoie*, No. 84-1601 (Apr. 22, 1986) slip op., at 13, 106 S. Ct. 1580, 1589 (1986). Because the Court of Appeal squarely held that the Eighth Amendment is not applicable in civil cases, this case provides an "appropriate setting" for resolution of this "important" issue that the Court declined to reach in *Lavoie*. Questions 2 and 3 raise substantial issues, also before the Court in *Bankers Life* and other cases, *see* notes 6 & 7 *infra*, regarding the imposition of punitive damages for violation of unforseeable, retroactively applied legal standards and regarding the procedures under which punitive damage awards are assessed in civil actions in California and other States.

All three of the questions presented by this case arise out of a government system created and maintained by the state courts and state judicial officials in which the coercive power of the State to administer punishment for antisocial conduct has been shared with private litigants and civil juries. This peculiar arrangement is an "anomaly" in "our legal system," in which, normally,

> damages are awarded to compensate the victim—to redress the injuries that he or she actually has suffered. In sharp contrast to this principle, the doctrine of punitive damages permits the award of "damages" beyond even the most generous and expansive conception of actual injury to the plaintiff.

Smith v. *Wade*, 461 U.S. 30, 57-58 (1983) (Rehnquist, J., dissenting) (citations omitted). Within this system,

private plaintiffs such as respondent, a savings and loan association, act as prosecutors. But, rather than functioning as government officials with broad and uniform governmental policies to administer and with compensation determined according to the services performed, these private prosecutors are interested exclusively in securing the greatest possible punishment in an individual case, because they receive the punitive fines which "should go to the State." *Id.*, at 59 (Rehnquist, J., dissenting).

Under the punitive damage system, putative defendants are not given notice of clear legislative standards of conduct, deviation from which may result in the imposition of specified levels of punishment. Instead, hundreds of trial and appellate courts in California sit each day as mini-legislatures, formulating and reformulating substantive legal standards of conduct the violation of which will expose defendants such as petitioner herein to enormous and completely unpredictable punitive damage awards (as long as juries can find "oppression, fraud or malice, express or implied" under *Cal. Civ. Code* § 3294 (Deering 1976)). Under this Orwellian system, there are no legislatively or judicially established limits on the amount of punishment which may be inflicted by juries, leading to the understated observation that punitive damage awards are "frequently based upon the caprice and prejudice of jurors." *Smith* v. *Wade*, 461 U.S., at 59 (Rehnquist, J., dissenting). And, as the court below stated, "the wealthier the wrongdoer, the larger the award of punitive damages."[3] App. A, *infra*, 28a,

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[3] As the appellant in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987), argues, a

189 Cal. App. 3d, at 1099-1100, 234 Cal. Rptr., at 851.

The magnitude of the punitive damage award in this case and the manner in which it was imposed are the inevitable, yet unpredictable, products of a system fundamentally out of control in which fines are becoming larger and are imposed more frequently. Between 1980 and 1984, punitive damages were assessed against thirty-five percent of defendants in California who were found to have breached contracts. M. Peterson, S. Sarma & M. Shanley, *Punitive Damages* viii, 10-11 (Rand Institute for Civil Justice 1987). During this same period in Los Angeles County, where this case was tried, punitive damage awards in bad faith cases had risen to the point where they *averaged* over $3,000,000. *Id.*, at vii, 37. And between June 17, 1987 and July 11, 1987, juries in California returned verdicts in three separate cases involving commercial banks for an aggregate of more than $102,000,000 in punitive damages.[4] On July 15, 1987

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system which permits juries to impose punitive fines in unlimited amounts based upon the wealth of the defendant is fundamentally offensive to the Excessive Fines Clause and the Due Process Clause of the Fourteenth Amendment. *See* Br. of Appellant, at 36 n.20.

[4] *Conlan* v. *Wells Fargo Bank*, No. 82852 (Cal. Super. Ct., Monterey Cnty July 11, 1987) ($50,000,000 punitive damage award); *Stanghellini* v. *Bank of America*, No. 35448 (Cal. Super. Ct. Sutter Cnty June 19, 1987) ($30,000,000 punitive damage award); *The Bank of California, N.A.* v. *California Land & Equipment Leasing Co.*, No. 305952 (Cal. Super. Ct. Sacramento Cnty June 17, 1987) ($22,613,196 aggregate punitive damage award).

Washington, D.C. jury awarded $75,000,000 in punitive damages in a single products liability case.[5]

That the jury in this case, and California juries generally, are implementing a punitive system of justice beyond the effective control of the California judiciary is manifest. The "invidious practices," App. A, *infra*, 26a-27a, 189 Cal. App. 3d, at 1098-99, 234 Cal. Rptr., at 850-51, for which punitive damages are awarded are defined subjectively and after the fact. And, although the punitive damage award in this case was over six times larger than the largest previous punitive damage award affirmed by the Supreme Court of California in a first-party bad faith case, *see Neal* v. *Farmers Insurance Exchange*, 21 Cal. 3d 910, 148 Cal. Rptr. 389 (1978), that court refused even to review the award below.

The Due Process Clause of the Fourteenth Amendment and the Excessive Fines Clause of the Eighth Amendment should, in this case, be held applicable to prohibit state-sponsored and state-enforced punitive damage regimes which are flatly inconsistent with fundamental constitutional values.

A. The Excessiveness of the $5,000,000 Punitive Award Raises an Important, Recurring Question That Should Be Resolved by the Court

As stated by the court below, the purpose of punitive damages, and the punitive damage award in this case, is "to punish wrongdoers and thereby deter the commission of wrongful acts." App. A., *infra*, 25a, 189 Cal. App. 3d, at 1098, 234 Cal. Rptr., at 850, *quoting Neal* v. *Farmers Insurance Exchange*, 21

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[5] *Ealy* v. *Richardson-Merrill, Inc.*, Civ. No. 83-3504 (D.D.C. July 14, 1987).

Cal. 3d, at 928 n.13, 148 Cal. Rptr., at 399 n.13. In California, the maximum monetary punishment that could have been inflicted on petitioner if it had been found by a court to have violated an existing order prohibiting it from [k]nowingly" failing "in good faith . . . [to] effectuate prompt, fair and equitable settlement of claims" as required by *Cal. Ins. Code* § 790.03(h)(5) (Deering 1976), would have been $500. *Cal. Ins. Code* § 790.07 (Deering 1976). Thus, petitioner suffered the imposition of a fine 10,000 times greater than the maximum monetary sanction it could have received for roughly analogous conduct, and over forty times as great as the compensatory damages awarded by the jury. This punitive fine was imposed in a civil action in which virtually no limit was placed on the verdict that could be returned. Indeed, it is apparent that in California the "gentle rule that [punitive damages] not be excessive," *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974), has become meaningless because trial and intermediate appellate judges in California will not exercise any control over the unfettered discretion of juries to punish defendants in sums bearing no relationship to a uniform, coherent and rational system of punishment. And, as in this case, the Supreme Court of California may decline even to review the jury's verdict.

As appellant Bankers Life and Casualty Company demonstrates in its opening brief in this Court, the concept of proportionality and moderation for governmentally imposed punishments carried from Chapter 20 of Magna Carta into the Eighth Amendment provides substantial protection from the infliction of excessive monetary punishment. *Bankers Life and Casualty Co.* v. *Crenshaw, supra*, Br. of Appellant,

at 25-27, 36-39. By any standard the Court might adopt in that case or the case at bar, the punishment inflicted on petitioner is constitutionally excessive.

B. Whether a Punitive Damage Award May Be Sustained on the Basis of the Application of a Substantive Legal Standard Non-existent When the Alleged Wrongful Conduct Occurred Presents a Substantial Question Requiring Resolution by the Court

As the Court has recognized repeatedly, the Due Process Clause of the Fourteenth Amendment requires that, when the States prohibit certain conduct and punish individuals who violate such prohibitions, they must articulate the prohibitions in terms sufficiently clear to avoid "arbitrary and discriminatory enforcement." *Kolender* v. *Lawson*, 461 U.S. 352, 357 (1983); *Hoffman Estates* v. *The Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 494 (1982). Because punitive damages "serve the same function as criminal penalties and are in effect private fines," *Rosenbloom* v. *Metromedia, Inc.*, 403 U.S. 29, 82 (1971) (Marshall, J., dissenting), and because the Court has recognized that due process concerns are implicated by any state action which affects a person's "freedom from . . . punishment," *Ingraham* v. *Wright*, 430 U.S., at 674, the Court should decide in this case that punitive fines may not be assessed by juries in civil actions, any more than they may be assessed in criminal prosecutions, unless the basic requirements of the Due Process Clause are met. Those requirements include, at a minimum, fair notice of the type of conduct which will subject a person to monetary punishment and fair notice regarding the range of monetary punishments which may be imposed for deviation from the standard.

As this Court observed in *Aetna Life Insurance Co.* v. *Lavoie*, slip op., at 8, 106 S. Ct., at 1586, "the law in the area of bad faith refusal-to-pay claims in Alabama, as in many other jurisdictions, [is] unsettled . . . ." It seems clearly the antithesis of due process to be punished for violating unsettled standards. However, here it was even worse. The petitioner was held liable for punitive damages notwithstanding that its conduct was in accord with standards apparently settled in its favor by the California courts at the time the conduct at issue occurred and agreed to in writing by its insured.

Until the decision of this case, the issuer of a fidelity bond which contained a promise to indemnify for defense costs, with an option in the insurer to take over the defense of an insured, might reasonably have assumed that if it did not wish to exercise that option, it could await the conclusion of the underlying litigation before discharging its duty to indemnify. Indeed, the insurer here could also have reasonably relied upon its insured's written statement that it would await completion of the underlying litigation before asserting a right to indemnification for defense costs. The insurer's conduct and the insured's agreement would have been perfectly consistent with the law as articulated by the Supreme Court of California in *Gray* v. *Zurich Insurance Co.*, 65 Cal. 2d 263, 54 Cal. Rptr. 104 (1966), and reemphasized by the California Court of Appeal in 1986:

> [t]he duty to defend is much broader than the duty to indemnify. . . . Unlike the duty to indemnify, *which is only determined after liability is established*, the duty to defend must be assessed at the outset of the case.

CNA Casualty of California v. *Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276, 278-79 (1986) (citations omitted) (emphasis added).

Under *Gray*, the duty to defend an insured in California pursuant to a general liability policy arises if that policy leads the insured "reasonably to expect such defense . . . ." 65 Cal. 2d, at 275, 54 Cal. Rptr., at 112. Under that duty, an insurer "must defend a suit which *potentially* seeks damages within the coverage of the policy . . . ." *Id.*, 54 Cal. Rptr., at 112. That, however, had never been the standard by which the duty to indemnify was measured under a fidelity bond. In this case, the Court of Appeal for the first time held that the standard governing the duty to indemnify is just as broad, indeed identical to, the scope of the duty to defend. Thus, although Ohio had not assumed a duty to defend Downey unless it chose to do so, it nonetheless was held to have an obligation to fund the defense as soon as it learned of the facts which put it on notice of its potential ultimate liability under its policy. In effect, the court below converted the fidelity bond at issue into a contract under which petitioner was punished for its decision not to indemnify respondent on the same basis as if it had breached a duty to defend—a duty which petitioner never undertook and for which respondent never bargained.

Not only was Ohio's contractual liability to indemnify judged by a new standard, it was punished by a $5,000,000 fine because it had failed to conform its conduct to that unforeseen and unforeseeable standard. A majority of the Members of this Court has recognized that "the alleged deterrence achieved by punitive damage awards is likely to be outweighed by the costs—such as the encouragement of unnecessary

litigation and the chilling of desirable conduct—flowing from the rule, at least when the standards on which the awards are based are ill-defined." *Dun & Bradstreet, Inc.* v. *Greenmoss Builders, Inc.*, 472 U.S. 749, 780 n.4 (1985) (Brennan, J., dissenting, joined by Marshall, Blackmun & Stevens, JJ.), *quoting Smith* v. *Wade*, 461 U.S., at 59 (Rehnquist, J., dissenting). As argued by the appellant in *Bankers Life and Casualty Co.* v. *Crenshaw*, *supra*, the imposition of punitive damage awards on the basis of the reformation of insurance contracts through retrospective application of new, judge-made substantive rules fashioned on a case-by-case basis cannot be reconciled with fundamental tenets of due process protected by the Due Process Clause of the Fourteenth Amendment.[6]

The substantive legal standard under which the punitive award was affirmed by the court below was not only "ill defined" but was non-existent when the

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[6] The essence of petitioner's Due Process Clause challenge based upon the application to the case at bar of newly formulated legal standards is argued to the Court by the appellant in *Bankers Life and Casualty Co.* v. *Crenshaw*, *supra*, Br. of Appellant, at 40-43. Similar challenges to punitive damage awards are also presented by the petitioner in *Allstate Insurance Co.* v. *Hawkins*, *supra*, Pet. for Cert., at 22-23, and by the petitioner in *Aluminum Co. of America* v. *Sliman*, *pet. for cert. filed* Mar. 31, 1987 (No. 86-1569) Pet. for Cert., at 8-11.

In the instant case, as well as *Crenshaw*, *Hawkins* and *Sliman*, this federal question was not fully mature until the highest appellate court having jurisdiction over the case had announced and applied new substantive law to sustain the punitive damage awards. In these circumstances, presentation of this Due Process Clause issue in petitioner's Petition for Review filed in the Supreme Court of California was timely. *E.g.*, *Brinkerhoff-Faris Trust Co.* v. *Hill*, 281 U.S. 673, 677-78 (1930).

insurance contract at issue was entered and performed. Whatever interest the State of California may have in the prospective regulation of insurance contracts between private parties having, as here, equal bargaining strength, California surely has "no . . . interest in securing for [respondent a] gratuitous award[] of money damages far in excess of any actual injury," *Gertz* v. *Robert Welch, Inc.*, 418 U.S., at 349, substantial enough to justify the application in this case of new, critically unfavorable law in order to affirm an excessive punitive damage award.

C. The Question Whether Punitive Damages May Be Imposed Absent Federal Constitutional Protections Accorded to Defendants in Criminal Cases Should Be Decided by the Court

Punitive damages in California, as in other jurisdictions, comprise a governmentally sponsored system for imposing penal fines for the purpose of enforcing society's standards of behavior through punishment and deterrence. In *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144, 165-66 (1963), the Court struck down a federal statute under which persons were punished with loss of citizenship in proceedings that did not afford them the procedural safeguards guaranteed by the Fifth and Sixth Amendments. As noted above, punitive damages are imposed in California solely for the purposes of punishment and deterrence. This Court has commented on the close relationship between punitive damages and fines imposed in criminal cases, stating that

> [p]unitive damages "are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence."

Electrical Workers v. *Foust*, 442 U.S. 42, 48 (1979), *quoting Gertz* v. *Robert Welch, Inc.*, 418 U.S., at 350.

Question 3—whether "a punitive 'fine' should be imposed after a *civil* trial," *Smith* v. *Wade*, 461 U.S., at 59 (Rehnquist, J., dissenting) (emphasis added)—is manifestly of great importance and worthy of plenary consideration by the Court in the case at bar.[7] Petitioner was punished in the sum of $5,000,000 by the court below for "invidious practices," such as instructing its claims adjusters to keep its defenses " 'in the forefront' " of its investigation of claims. App. A, *infra*, 27a, 189 Cal. App. 3d, at 1098, 234 Cal. Rptr., at 850. By permitting the award of punitive damages to private plaintiffs for an insurer's conduct toward other insureds, the States have, for all practical purposes, conferred on those plaintiffs the power to prosecute defendants for antisocial "invidious" or "reprehensible" conduct generally. If a violation of such a vague standard is perceived by a jury, then these private prosecutors may impose on and collect from defendants monetary punishments which are constitutionally indistinguishable from, and generally vastly greater than, the punitive fines imposed upon conviction after proof beyond a reasonable doubt for more egregious, clearly prohibited antisocial conduct after a criminal trial. This civil imposition of highly oppressive criminal punishment for the benefit of private prosecutors and their counsel cannot be reconciled with the Court's cases, which require that before the States may impose sanctions in order to punish and deter antisocial conduct, the guarantees of the

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[7] This question is also presented as Question 2 by the petitioner in *Allstate Insurance Co.* v. *Hawkins*, *supra*.

Fifth and Sixth Amendments must be accorded to defendants.

CONCLUSION

The Court's resolution of the questions presented by petitioner will have a substantial impact on matters that are arising daily in the courts of this Nation and are dramatically changing the character of litigation conducted throughout the United States. The California court system has firmly rejected petitioner's arguments that the United States Constitution applies in important respects to control the size of punitive damage awards and the circumstances under which such awards may be imposed. Petitioner respectfully prays that this Petition be granted and that these questions be set for plenary consideration.

July 22, 1987

Respectfully submitted,

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APPENDIX

APPENDIX A

In The Court of Appeal

State of California

SECOND APPELLATE DISTRICT

DIVISION THREE

Sup. Ct. No.
C 262 871

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Plaintiff, Appellant and Cross-Respondent,

v.

THE OHIO CASUALTY INSURANCE COMPANY,
Defendant, Respondent and Cross-Appellant.

APPEAL from a judgment of the Superior Court of Los Angeles County. Paul G. Breckenridge, Jr., Judge. Affirmed in part and reversed in part. Remanded with directions.

George C. Montogmery, Bruce M. Thronton, Montgomery, Gascou, Gemmill & Thornton and Robert E. Jones, attorneys for Defendant, Respondent and Cross-Appellant.

Saphier and Rein and Michael S. Saphier, attorneys for Plaintiff and First Appellant.

OPINION

Kennard, J.*—Plaintiff Downey Savings and Loan Association (hereafter Downey) brought a bad faith action against defendant Ohio Casualty Insurance Company (hereafter Ohio) for denial of benefits under a fidelity bond issued by Ohio. A jury awarded Downey $152,983.43 in compensatory damages and $5,000,000 in punitive damages. Downey appeals from that portion of the judgment denying it attorney's fees, while Ohio cross-appeals from the judgment against it. Reversed as to Downey's appeal.

FACTS

Viewing the evidence in the light most favorable to Downey, as we must (*Leff v. Gunter* (1983) 33 Cal.3d 508, 511; [189 Cal.Rptr. 377, 658 P.2d 740]; *Moore v. American United Life Ins. Co.* (1984) 150 Cal.App.3d 610, 616, fn. 2), the facts are as follows:

A. Facts Relating to Downey's Claim Based on Employee Dishonesty

On February 1, 1973, Ohio issued a "Savings and Loan Blanket Bond" to Downey. The bond provided coverage for losses caused by the dishonest act of any of Downey's employees, up to a maximum of $3 million. The bond also promised to indemnify Downey for court costs and attorney's fees incurred by Downey in defending any lawsuit brought by a third party arising out of the dishonest acts of Downey's employees.

In late 1974, Steven Jones and Ronald Noday concocted a scheme whereby checks with insufficient funds would be used to buy certificates of deposit, which would then be pledged as security for loans from third-party lenders. The bad checks would be provided by Noday or his associates, Arthur Madison and William Beverly Smart. Having heard

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* Assigned by the Chairpersons of the Judicial Council.

from his brother-in-law that Dennis McGrew, manager of Downey's branch in Rolling Hills, might be interested in making "some extra money," Jones invited McGrew to Noday's house in Palos Verdes on October 31, 1974. After a six-hour meeting, McGrew agreed to participate.

On December 11, 1974, McGrew wrote to the Bank of America in Sacramento that Madison and Noday were valued clients of Downey's and could place large certificates of deposit, up to a total of $1 million, with the Bank of America. Though McGrew's signature was on the letter, it had been drafted by Madison. Also, neither Noday nor Madison had an account with Downey.

On December 31, 1974, Noday obtained a check for $100,000 from Madison to open an account at Downey's Rolling Hills branch office in the name of Laurence A. Smith, Jr. There were insufficient funds to cover the check, a fact known to McGrew. Three days later, Noday opened another account at Downey's Rolling Hills branch, this time in his name, with a check for $220,000 drawn on a bank in the Bahamas, whose president was a friend of Noday's. This too was a bad check, and McGrew knew this.

In early January 1975, Noday and his associates applied to American Funding for a loan to CTR Leasing Company, which was controlled by Smart, pledging the $100,000 Smith account at Downey's as collateral. In response to a telephone call from an American Funding employee, McGrew verified the existence of the $100,000 certificate of deposit, even though he already knew the check had been dishonored because it was drawn on a closed account. The American Funding employee also made an appointment to see McGrew later that day to have him sign an assignment of the account. McGrew specifically mentioned to his assistant, Linda Johnson, that he had to sign an assignment that afternoon. As part of the plan worked out with Noday and Jones, however, McGrew left for lunch

at 3:00 p.m., before the arrival of the American Funding employee. When the latter arrived at the bank and found that McGrew was not there, she became upset, saying she had an appointment with him. Assistant manager Linda Johnson signed the assignment. Later McGrew told Jones everything had worked out as planned and since he did not sign the assignment he would not be directly connected with it.

Upon McGrew's return to the bank later in the day, Johnson showed him a copy of the assignment she had signed. The document stated there were no liens, holds or emcumbrances on the Smith account, and certified that the account was fully insured. McGrew knew this information to be false, but he did not notify American Funding or anyone at Downey's thereof. Relying on the signed assignment American Funding issued Smart a cashier's check for $100,000 in the late afternoon of January 8, 1975. The check was cashed the next day.

In late January 1975, Noday tried to obtain a second loan from American Funding by pledging his $220,000 account at Downey's as collateral. The chief executive officer at American Funding, A. Gordon Elder, became suspicious when he noticed that the assignment executed by Downey did not contain the name of the assignee. He paid a visit to Richard Bond, vice-president at Downey's main office in Downey, and asked if it was Downey's practice to leave the name of the assignee blank. When Bond replied it was not, Elder showed him the assignment of the $220,000 account. Elder also showed Bond the assignment of the $100,000 account and asked about its validity, adding he had already made a loan on the $100,000 but not on the $220,000 account. When Bond discovered a zero balance on the $100,000 account, he told Elder he would have to do some further checking and would telephone him later, but that the $220,000 assignment was not valid and would not be honored by Downey.

Unable to collect on the $100,000 loan to the company controlled by Smart, American Funding sued Downey. Downey requested Ohio to pay its attorney's fees in defending the American Funding lawsuit, but Ohio refused to do so, claiming no liability under the fidelity bond it had issued to Downey.

B. Facts Relating to Ohio's Bad Faith

John H. Rehm, Jr., assistant vice-president at Ohio and its superintendent of the bond claims department at Ohio, supervised all of Ohio's bond claims on a nationwide basis. He also wrote Section 18 of Ohio's claims manual setting forth the standards for the handling of bond claims. Those standards were consistent with the standards of the insurance industry, and included the following: (1) upon receipt of notice of any occurrence, the underwriter was to immediately refer the matter to the claims department; (2) if review by the claims department indicated the possibility of a claim, an adjuster was to be assigned immediately and an investigation commenced forthwith, requiring contact with the insured within 24 hours after an adjuster's assignment, and prompt contact with the allegedly dishonest employee.

On January 31, 1975, within 48 hours after the meeting between Downey's Bond and American Funding's Elder, Downey notified Ohio of the circumstances surrounding the $100,000 and $220,000 transactions. A second notice to Ohio was given on February 3, 1975. Ohio, however, took no action and did not refer the matter to its claims department, even thought it knew of Downey's belief that an "inside man" was involved.

On February 28, 1975, Downey's Bond wrote a letter to Judith Nye, the insurance agent for Ohio, mentioning McGrew's representation to the American Funding employee that he would sign the assignment of the $100,000 account even though McGrew had learned the previous day that the $100,000 check used to open the account at Dow-

ney had been dishonored. It was not until May 19, 1975, that Ohio's claims department received the February 28, 1975, letter. Robert Shafer, manager of Ohio's claims department, sent a copy of the letter to Rehm with the notation, "questioning possible fraud or embezzlement." Shafer also sent Rehm a letter from Nye stating that McGrew was no longer employed by Downey. Shafer assigned the matter to adjuster Robert Jones for investigation.

On May 23, 1975, Rehm wrote Shafer a memorandum in which he acknowledged the possibility of employee dishonesty but warned Shafer not to waive any defenses under the bond. Rehm then assigned a claim number to the matter, and established a reserve, that is, an estimate of the value of the claim. No attempt was made to interview any of the persons involved in the transaction. Ohio's first contact with Downey was by letter dated May 29, 1975, stating that Ohio did not receive notice of the transaction until May 19, 1975. Rehm admitted in court that Ohio was given notice on January 31 and February 3, 1975, but that Ohio used the May 19, 1975, date to set up its defense of late notice under the bond. Rehm also said he knew the letter contained false information, but that he did nothing to correct it.

A copy of Ohio's May 29, 1975, letter to Downey was sent to Judith Nye. She immediately called Shafer, telling him the May 19, 1975, date was incorrect since she had personally notified Ohio in late January and early February 1975 of the incident. Shafer told Nye, "Don't worry about it. It is just a form letter. It goes to everybody."

In late July 1975, Ohio conducted a 20-minute interview with Richard Bond. A memorandum of the interview was written on August 27, 1975, and a copy was sent to Rehm. Rehm testified that after reading the results of the investigation, he suspected McGrew's involvement in both the $100,000 and $220,000 transactions, but he never in-

structed anyone at Ohio to interview McGrew, even though he realized such an interview was necessary to complete Ohio's investigation. On September 5, 1975, Rehm wrote a memorandum to the claims department to keep "all possible defenses in the forefront" of the investigation.

After receiving Rehm's letter, claims adjuster Robert Jones on September 9, 1975, talked to Helmut Bauer, an investigator for the Major Frauds Division of the District Attorney's office, about the McGrew incidents involving the $100,000 and $220,000 checks. The interview lasted 10 minutes. Thereafter, Jones wrote a memorandum stating that Bauer had told him of McGrew's innocence in the scheme. Bauer, however, denied making such a statement.

In early February 1976, Rehm received a copy of American Funding's complaint against Downey. He recognized the possibility of McGrew's dishonesty with respect to the $100,000 transaction and the potential for liability under the bond. Still he saw no need to interview McGrew or anyone else involved with the transaction.

After his indictment, Steven Jones entered into a plea bargain with the district attorney. At the trial, he directly implicated McGrew. A transcript of Jones's testimony was forwarded to Ohio on October 31, 1977. Upon review of the transcript, Rehm concluded that if Jones had testified truthfully, McGrew's conduct would be covered as a dishonest act under the bond. But Rehm did not believe Jones's testimony, taking the position there would be coverage under the bond only if McGrew made a confession or admission of guilt. Rehm nevertheless concluded in an internal memorandum that since "employee dishonesty could grow out of these facts," the establishment of a $25,000 reserve was called for as a precautionary measure. Ohio notified Downey there was no coverage under the bond, and hence no liability for Downey's costs and attorney's fees incurred in the American Funding lawsuit.

On November 21, 1978, Downey sued Ohio for indemnity, declaratory relief, and interference with a protected property interest. The complaint was later amended to allege a cause of action for breach of the implied covenant of good faith and fair dealing. Downey alleged as part of its damages court costs and attorney's fees it already had incurred and would be incurring in the action.

On July 23, 1980, Ohio took McGrew's deposition. In November 1980, American Funding moved for summary judgment against Downey. The motion described McGrew's involvement in the scheme to defraud Downey. Downey sent a copy of the motion to Ohio. Ohio maintained there was no coverage under the bond.

In late 1983, trial commenced in this case.

ISSUE ON DOWNEY'S APPEAL

The sole issue raised by Downey on appeal involves the propriety of the trial court's ruling denying Downey to recover as part of its damages attorney's fees and court costs incurred in its bad faith action against Ohio.

ISSUES ON OHIO'S CROSS-APPEAL

On the cross-appeal by Ohio, we are asked to determine the propriety of (1) the trial court's denial of Ohio's motion to have the bad faith action tried separately from the other issues, (2) the trial court's summary adjudication of certain issues, (3) the trial court's rulings on certain evidentiary issues, (4) the trial court's instructions to the jury, and (5) the jury's award of punitive damages based on its finding that Ohio acted in bad faith towards Downey.

DISCUSSION

I. DOWNEY'S APPEAL

On September 14, 1983, prior to trial in the case at bench, the court granted Downey's motion to have the

issue of attorney fees on the bad faith action tried after the jury's verdict on the other issues. On November 21, 1983, the court granted Ohio's motion barring Downey from introducing evidence on the issue of costs and attorney's fees incurred in Downey's bad faith action against Ohio. The court then ruled that Downey's attorney's fees were "not a recoverable item of damages."

Citing *Brandt v. Superior Court* (1985) 37 Cal. 3d 813, [210 Cal.Rptr. 211, 693 P.2d 796] Downey contends the court's ruling was improper. We agree. In *Brandt,* the state Supreme Court held that when an insurer tortuously withholds benefits, the insured is entitled to recover attorney's fees incurred to compel payment of the policy benefits. As the court said, "The attorney's fees are an economic loss—damages—proximately caused by the tort." (*Id.,* at p. 817.)

We conclude the trial court's ruling was improper. (*White v. Western Title Ins. Co.* (1985) 40 Cal. 3d 870, 890 [221 Cal.Rptr. 509, 710 P.2d 309]; *Brandt v. Superior Court, supra,* 37 Cal. 813, 819.) The matter is reversed and remanded for a determination of the attorney's fees to which Downey is entitled under *Brandt.*

II. OHIO'S CROSS-APPEAL

A. DENIAL OF BIFURCATION OF TRIAL

Ohio contends the trial court committed reversible error in denying Ohio's request to have Downey's cause of action for breach of the implied covenant of good faith and fair dealing tried separately from the issue of liability under the bond.

Whether there shall be a severance and separate trials on issues in a single action is a matter within the discretion of the trial court, whose ruling will not be disturbed on appeal absent a manifest abuse of discretion. (*McArthur v. Shaffer* (1943) 59 Cal.App.2d 724, 727.) [139 P.2d 959]

(2b) In denying the motion for severance, the trial court noted that the evidence on the issue of Ohio's bad faith was interrelated with the issue of coverage under the bond, that the issues were not "that complex", and that it had "great confidence in the ability of the jury to follow the court's instructions." We find nothing in this case that compels a conclusion of an abuse of discretion by the trial court in denying the motion for severance. (*McArthur v. Shaffer, supra,* at pp. 727-728.) Nor do we find merit in Ohio's claim the trial court's ruling "substantially tilted the scales in favor of Downey."

B. PROPRIETY OF SUMMARY ADJUDICATION OF CERTAIN ISSUES

Code of Civil Procedure section 437c, subdivision (f) provides that when a party moves for summary adjudication of issues, and it appears that the evidence supports the granting of the motion, the court shall issue an order specifying that "such issues are without substantial controversy." The action then proceeds as to the remaining issues. "The purpose of a partial summary judgment is to dispose of one or more issues before trial so that the parties may focus on the questions remaining." (*Conway v. Bughouse, Inc.* (1980) 105 Cal.App.3d 194, 202 [164 Cal.Rptr. 585].) Summary judgment is proper if no material factual issue exists (*Avila v. Standard Oil Co.* (1985) 167 Cal.App.3d 441, 446. [213 Cal.Rptr. 314].) Our review is limited to the facts shown in the documents presented to the trial court in making our independent determination of their construction and effect as a matter of law. (*Bonus-Built, Inc. v. United Grocers, Ltd.* (1982) 136 Cal.App.3d 429, 442. [186 Cal.Rptr. 357].)

1. Indemnification of Attorney's Fees

The bond provided coverage for any loss incurred as a result of dishonest or fraudulent acts of any of Downey's employees. Under the bond, Ohio had the option of defending Downey or indemnifying it for court costs and

attorney's fees incurred in the defense of a third-party lawsuit to enforce the insured's liability for any loss suffered by the third party which, "if established against the Insured, would constitute a valid and collectible [*sic*] loss sustained by the Insured under the terms of the bond." The trial court summarily adjudicated that under the bond Ohio was liable for costs and attorney's fees Downey incurred in its defense against American Funding's complaint. The court ruled that such liability started on October 31, 1977, the date on which Downey sent Ohio a transcript of the testimony of Steven Duane Jones implicating McGrew. Ohio contends the summary adjudication was improper because the American Funding complaint filed against Ohio contained no allegation of employee dishonesty.

The documentary evidence before the trial court showed the following: Starting in late January 1975, and continuing thereafter, Downey notified Ohio of the incidents involving McGrew and its suspicions of the latter's dishonesty in those matters. On October 31, 1977, Downey sent Ohio a transcript of the testimony given by Steven Jones at the American Funding trial implicating McGrew in the scheme to defraud Downey. After receipt thereof, Ohio acknowledged in an internal memorandum written on November 28, 1977, that "employee dishonesty could grow out of these facts," calling for the establishment of a reserve of $25,000 as a precautionary measure. In subsequent letters to Downey, however, Ohio maintained there was no coverage under the bond and thus no duty on the part of Ohio to defend or indemnify Downey for its attorney fees and court costs incurred in the American Funding lawsuit. Ohio took the position that the complaint by American Funding contained no allegation of employee dishonesty, and therefore there was no liability under the bond.

At the hearing on summary adjudication of the issue of indemnification of attorneys fees incurred in the lawsuit

filed by American Funding, Ohio argued it doubted the truthfulness of Jones's testimony and summary adjudication would therefore be improper. In granting summary adjudication, the trial court said: "The undisputed documentary evidence shows that by October 31, 1977, a witness had testified to fraudulent or dishonest acts on the part of a Downey employee, McGrew, and that Ohio, on or about that date was made aware of that testimony. It is not a true issue here, and hence is irrevelant to determination of this motion, whether the testimony of that witness (Jones) was or was not true. What is important is that clearly by this date Ohio was aware of facts claimed to exist which showed a potential liability on the part of Downey (*Gray v. Zurich, etc.*, 1966, 65 C.2d 263, 276)."

Whether American Funding's complaint contained allegations that its claim against Downey was of the nature covered by the bond issued to Downey by Ohio, or whether Ohio disbelieved the testimony of Jones directly implicating McGrew in the scheme to defraud Downey, was irrelevant, and the trial court properly so found. "Inadequate allegations of a third party's complaint are not determinative of an insurer's obligation to defend if the insurer learns from the insured or other sources facts which give rise to the potential of liability under its policy." (*Hartford Accident & Indem. Co. v. Civil Service Employees Ins. Co.* (1973) 33 Cal.App.3d 26, 34 [108 Cal.Rptr. 737]; *Gray v. Zurich Insurance Co.* (1966) 65 Cal.2d 263, 276-277 [54 Cal.Rptr. 104, 419 P.2d 168]; *CNA Casualty of California v. Seaboard Surety Co.* (1986) 176 Cal.App.3d 598, 607) [222 Cal.Rptr. 276].)

2. The Bond's Requirements of Notice of Loss and Proof of Loss

Ohio contends that trial court erred in granting summary adjudication against Ohio on its affirmative defense that Downey had failed to comply with the bond's requirements of notice of loss and proof of loss. The bond required

Downey to furnish Ohio with a written notice of loss at "the earliest practicable moment after discovery of any loss," and to supply proof of loss within six months of the discovery of loss. In granting summary adjudication on this issue, the trial court said: "This defense relates to a claimed failure by Downey to give written notice of loss at the earliest practicable moment and within six months. No facts of prejudice to Ohio are shown and it is affirmatively shown that Ohio executives have testified that there was not prejudice. In the absence of prejudice an insurer may not rely on a breach of a notice clause. (*Campbell v. Allstate Insurance Co.* (1963) 60 Cal.2d 303, 306 [32 Cal.Rptr. 827, 384 P.2d 155].) Further, having denied liability, Ohio waived any claim of noncompliance with the provisions. (*Walters v. American Insurance Co.*, 1960, 185 CA.2d 776, 787]8 Cal.Rptr. 665].)"

Ohio argues on appeal that in fidelity insurance prompt notice of loss is crucial because this enables the insurer to immediately investigate the matter and thereby avoid losses which would otherwise be irremediable. Time is especially of the essence, Ohio continues, in a case such as this which involves embezzlement. Downey's response thereto is that since it did not suffer a loss until it paid American Funding $55,000 to settle the lawsuit, it could not have notified Ohio of the "loss" or furnished Ohio with a proof of the loss suffered prior to the settlement.[1]

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[1] There was correspondence between the parties during litigation of the American Funding lawsuit in which both parties expressed their understanding that Downey had not sustained a loss within the meaning of the bond. For instance, on March 17, 1976, Ohio wrote to Downey: "The insured, Downey Savings and Loan Association, has not sustained any loss as of this date by reason of the transaction alluded to in the complaint." And in November 1977, Downey's counsel sent this letter to Ohio's counsel: "It is Downey's understanding that since it has not yet sustained any loss except for its litigation costs, no proof or loss is required at the present time, and the provisions giving rise to the limitations in which the legal proceedings can be commenced for recovery of any loss would not come into play until the actual loss sus-

In support, Downey cites *Pacific- Southern Mortgage Trust Co. v. Insurance Co. of North American* (1985) 166 Cal.App.3d 703 [212 Cal.Rptr. 754]. There the court interpreted the term "discovery of the loss" under a bond to mean the time when the insured discovers it has suffered a *loss,* not the time when the insured discovers a *potential loss.* (*Id.,* at p. 711.) As the court said, "[I]t is logical to start the running of the bond's limitation period upon discovery of a real loss rather than discovery of an anticipated loss." (*Id.,* at p. 712.) Under *Pacific-Southern,* therefore, Downey did not suffer a loss until it settled the American Funding lawsuit for $55,000. Also, here the bond did not provide indemnity against liability, but indemnity against loss, and thus did not cover anticipated or even uncertain future losses but only actual losses. If Ohio had wanted written notice upon discovery of the fraud, it could have so stated in the bond. As the court in *Pacific-Southern* noted, some blanket fidelity bonds specifically require an insured to report " 'an occurrence which may give rise to a claim.' " (*Id.,* at p. 711.)

Moreover, though an insurer may assert a defense based upon an alleged breach of the notice requirements of the policy, the breach cannot be a valid defense unless the insurer was substantially prejudiced thereby. (*Clemmer v. Hartfod Insurance Co.* (1978) 22 Cal.3d 865, 833-884; *Campbell v. Allstate Ins. Co.* (1963) 60 Cal.2d 303, 305. [32 Cal.Rptr. 827, 384 P.2d 155]) (9b) Ohio has not made such a showing. The record shows that Ohio had adequate notice of *potential* liability to prevent any substantial prejudice to its interests. (*CNA Casualty of California v. Seaboard Surety Co., supra,* 176 Cal.App.3d 598, 617.) Furthermore, in denying liability under the bond, Ohio has waived any claim that Downey has not complied with the notice requirements of the bond. (*Ibid.; Walters v. Amer-*

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tained by Downey has been determined. If this understanding is incorrect, we would . . . appreciate your advising me [sic] immediately." Ohio did not advise Downey to the contrary.

ican Ins. Co. (1960) 185 Cal.App.2d 776, 787. [8 Cal.Rptr. 665].)

3. Ohio's Cross-complaint Against Downey Alleging Breach of Duty of Good Faith

In its cross-complaint, Ohio alleged that Downey had breached its duty of good faith owed to Ohio by failing to comply with the the bond's provisions regarding notice and proof of loss, by not cooperating in the investigation of the claim, and by attempting to create coverage under the bond "falsely accusing McGrew of fraud." On appeal, Ohio argues the trial court's ruling was erroneous because the court "improperly refused to consider all affidavits presented," and the evidence was "wholly insufficient to negate a triable issue of fact." These contentions are supported by neither argument nor citation of authority; they are therefore deemed abandoned. (*Rossiter v. Benoit* (1979) 88 Cal.App.3d 706, 710 [152 Cal.Rptr. 65].) A reviewing court need not consider alleged error when the appellant merely complains of it without pertinent argument. (*Ibid.*) Moreover, having considered Downey's response to this issue on pages 66 through 68 of its cross-respondent's brief, we are convinced the trial court's summary adjudication was proper.

C. PROPRIETY OF TRIAL COURT'S EVIDENTIARY RULINGS

1. Admissibility of Testimony by Jones About His Conversation with Noday

Over Ohio's objection on the ground of hearsay, the trial court admitted the testimony of Duane Jones regarding a conversation he had with Noday in which Noday related the following: On February 12, 1975, he went to Downey's branch office in Rolling Hills to redeem the $100,000 check for cash he was carrying in a briefcase. The briefcase was filled half with money, half with paper. While the money was being counted, someone (Jones did not recall whether

Noday said it was McGrew) said the check was not at the bank. Upon hearing that, Noday immediately closed his briefcase, saying if the check was not there he was not going to hand over the money. Noday told Jones the interruption came at the right moment because he simply did not have sufficient cash with him. He had no intention of redeeming the check, he simply wanted to give the appearance of redeeming the check.

The trial court admitted the testimony on the basis of a coconspirator's statement under Evidence Code section 1223.

The conspiracy in this case included not only the illegal bank transactions but also the payment by Noday to Jones of a "finder's fee" for bringing McGrew into the conspiracy and a payment of 10 percent for every transaction going through Downey's. Jones, however, did not find out until the end of 1975 that in early January 1976 Noday had obtained a loan from American Funding based on the $100,000 certificate of deposit with Downey's, which was backed by a "bad" check. Jones testified he felt he should have been paid his "commission" for the transaction, and he was upset that no payment had been made to him.

Statements of conspirators made after commission of the crime which was the object of the conspiracy are admissible if the evidence shows that the conspiracy also contemplated payment of a certain sum to an accessory for his participation in the crime. As said in *People v. Ross* (1941) 46 Cal.App.2d 385, 396 [116, P.2d 81], " 'When a conspiracy disclosed an intention to divide property stolen, evidence of acts and declarations at any time before the division are admitted upon the theory the conspiracy does not end until that time.' " We conclude the trial court's admission of the challenged testimony in this case was proper.

2. Exclusion of Jones's Letter of October 25, 1983

Ohio sought to introduce into evidence a letter Jones had written to Downey's counsel stating he had met with two of Ohio's attorneys and expressing his opinion that Noday could have used McGrew without the latter knowing it. Downey objected on the ground that Jones's opinion was purely speculative, and the trial court agreed. Ohio contends the letter should have been admitted because of its relevance to "unfounded accusations of misconduct by Ohio's counsel." We have reviewed the letter. Since it contains nothing which explains or elaborates on the conduct of Ohio's counsel, we fail to see its relevance in this regard.

Ohio argues the letter should have been admitted under Evidence Code section 356. That section provides in relevant part that when part of a writing "is given in evidence by one party, the whole on the same subject may be inquired into by an adverse party." Here, Downey never offered any portion of the letter into evidence. It was Ohio who sought to admit the entire letter. Ohio's reliance on Evidence Code section 356 is misplaced.

3. Admission of Richard Bond's Testimony that Downey Terminated McGrew because of his Alleged Dishonesty

Over Ohio's objections on the grounds of irrelevancy and speculation, the trial court allowed Richard Bond, vice-president of Downey, to testify that he terminated McGrew because the latter had violated the bank's policy regarding assignments and because of the bank's suspicion of his involvement in the Noday transactions. The trial court's ruling was proper. The evidence was relevant as to Downey's bad faith claim that Ohio had conducted an inadequate investigation for failure, among other things, of finding out the reason for McGrew's termination. An internal memorandum written by Ohio's Rehm mentioned that coverage under the bond would extend only to em-

ployee dishonesty, that he thought the facts presented to him indicated stupidity rather than dishonesty by an employee of Downey's, but then went on to say that "there may be some inuendo [sic] in the facts as we now have them of employee dishonesty since Mr. McGrew, former branch manager of the Savings & Loan is no longer employed by them." Despite Ohio's awareness of possible employee dishonesty, Ohio nevertheless failed to inquire of Bond, Downey's vice-president, as to the reason for McGrew's termination.

Ohio also contends the trial court erred in sustaining Downey's objection to Ohio's question of Olga Mitchell, a teller at Downey's, whether she believed McGrew had committed any fraudulent acts. Mitchell's involvement in the transaction involving Noday was limited to counting the money Noday had brought in a briefcase. Any opinion of hers would have been purely speculative on the issue of McGrew's dishonesty. The trial court's ruling was therefore proper.

4. Exclusion of Character Testimony to Impeach Richard Bond

Bond denied receiving a telephone call from McGrew on either January 8 or 9, 1975, about the Smith assignment. He also testified he had no recollection of having met any of Ohio's representatives. Ohio attempted to attack Bond's character traits for honesty through the testimony of Stanly Pawlowski and Edward Lemonyne, employees of El Camino Bank, based on an alleged "check kiting" scheme which involved McGrew and occurred years after the McGrew incidents and after Bond had left Downey. In exercising its discretion under Evidence Code section 352 and sustaining Downey's objection to the proffered testimony, the trial court ruled that the probative value was slight and "likely to confuse" the jurors. As the court noted, "I realize that he was in charge at one point, but he has got a minimal memory and he can't dispute the

memorandums [sic] where they exist. They are there. They were directed to him. . . . [¶] It just seems that the fact that he got in some trouble later on really isn't all that significant. Nothing was ever prosecuted. . . . [¶] The fact that . . . his reputation in the minds of some people is rather negative . . . I think is likely to confuse the issue."

Except for proof of a felony conviction, specific instances of wrongdoing are not a proper basis for attacking a witness' credibility. (Evid. Code, §§ 787, 788; *Vick v. Patterson* (1958) Cal.App.2d 414, 416 [322 P.2d 548].) Here, there was no felony conviction. Bond's alleged involvement in a "checking kiting" scheme years after the McGrew incidents did not lead to a criminal prosecution.

We find no abuse of discretion in the exclusion of the proposed testimony. (*Wagner v. Benson* (1980) 101 Cal.App.3d 27, 36 [161 Cal.Rptr. 516].)

5. Exclusion of Certain Correspondence Between Counsel for Both Parties

Ohio contends the court erred in excluding certain correspondence between counsel for both parties in the course of litigating this case. Ohio argues such correspondence, which consisted of seven letters, was relevant because it showed a lack of cooperation by Downey in assisting Ohio with its investigation. Though Ohio has cited us to the pages in the clerk's transcript where these letters appear, it has failed to cite us to the appropriate pages in the reporter's transcript showing the trial court's ruling and the basis for it. In this case, the reporter's transcript has 26 volumes totaling 3868 pages, with the clerk's transcript containing 19 volumes totaling 7077 pages. A reviewing court cannot be expected to search through a voluminous record on a point raised by an appellant when his brief makes no reference to the pages where the issue was raised in the trial court. (*Metzenbaum v. Metzenbaum* (1950) 96 Cal.App.2d 197, 199 [214 P.2d 603].)

In any event, our review of the letters convinces us their exclusion was proper. The letters pertained to Ohio's pretrial discovery and preparation of a defense in the lawsuit brought by Downey. They did not constitute an investigation by Ohio into Downey's insurance claim. Therefore, they were only marginally relevant.

We reject Ohio's contention that the excluded evidence was admissible in the discretion of the trial court under Evidence Code section 352. To be admissible, the evidence had to be relevant (Evid. Code, § 350; *Brokoff v. Ford Motor Co.* (1977) 71 Cal.App.3d 841, 853 [139 Cal.Rptr. 888, 93 A.L.R.3d 537].) This test was not met here.

6. Exclusion of Purported Credit Report on American Funding

Ohio claims the trial court erred in excluding a purported credit report on American Funding, which was found in one of Downey's files during discovery proceedings. Ohio cites us to pages 6881 of the clerk's transcript where this report is duplicated. That page shows an illegible copy. Anyway, we find no error in the trial court's exclusion. When Ohio showed the document to Richard Bond (Downey's vice-president) and questioned him about it, Bond replied he knew nothing about the document, he had never seen it before, and he did not know how it found its way into Downey's file, adding that a number of Downey employees had access to the file. The trial court sustained Downey's objection to the document's admission into evidence on the grounds of lack of foundation and failure to authenticate the document. Without citation of authority, Ohio contends Downey had the burden of authenticating the document. Since Ohio was the proponent of the evidence, it had the burden of complying with the authentication requirements of Evidence Code section 1410.

7. Exclusion of Lie Dector Test Results

John Rehm (superintendent of Ohio's bond claims department) testified that during its investigation of the

McGrew incident Ohio never asked McGrew to submit to a lie detector test, doing so only on the eve of trial (eight years after the McGrew incident and almost five years after Downey's filing of the lawsuit against Ohio). Ohio did not object. It now claims that since Downey did bring up the fact that McGrew submitted to a lie detector test at Ohio's request, the trial court erred in not allowing Ohio to argue to the jury the results of the test.

The test results were never brought up in the course of the trial. Nor did a qualified witness testify as to the procedures used in administering the test. The only witness who testified regarding the taking of a polygraph test by McGrew was Downey's employee, John Rehm. Also, as the trial court noted, the probative force of the polygraph examination was diminished by the long lapse of time between the occurrence of the events and the taking of the test. The trial court did not err in not allowing Ohio to argue to the jury the results of the polygraph test taken by McGrew. (*United States v. Demma* (9th Cir. 1975) 523 F.2d 981, 987.)

D. JURY INSTRUCTIONS

At a hearing outside the jury's presence the trial court discussed proposed jury instructions with both counsel. Ohio argued that any obligation it had towards Downey under the bond was exonerated when Downey refused to accept Noday's tender of $100,000 on February 12, 1975, and that the court should so instruct the jury. In refusing to do so, the court noted that although a plaintiff has a duty to "use reasonable efforts to mitigate his damages," there was insufficient evidence of a tender by Noday and insufficient evidence "to go to a jury that Downey was negligent in not taking the money from Mr. Noday."

The pertinent evidence is as follows: On February 12, 1975, Noday appeared at Downey's Rolling Hills branch office without an appointment. He carried a briefcase, which contained cash on top and paper underneath. He

said he wanted to exchange $100,000 in cash for the Smith check he had deposited at an earlier date. While the money was being counted, Noday was told the check was not there. Noday immediately placed the money back in the briefcase, closed it and, saying he would not leave the money without getting the check back, left immediately. He later told Jones the bank's statement that the check was not there came just in time because he did not have all of the required cash with him, having filled his briefcase with half cash, half paper.

We agree with the trial court that under the circumstances there was no valid tender. As the trial court said, "I accept Mr. Steven Jones' testimony that Noday made this as a show without any intention of performing." Also, having conceded in the trial court there was no tender, Ohio may not now be heard to complain there was a proper tender.

After conceding there was no tender, Ohio argued that Downey's conduct in this regard constituted negligence. In rejecting the contention, the court said, "Now, after thinking about it and thinking about it, I can't say that there is any reasonable interpretation of this evidence that would show that Downey was negligent. . . . They were on the horns of a dilemma, a catch-22 situation, they hadn't actually experienced a loss yet, there was certainly an exposure, Noday wasn't asking for his own check, he was asking for Smith's check, he was making this big show with this cash. And, yet, he was very impatient, he wasn't going to sit there and wait for a day or two to go back, we know that for them to get a check from wherever it might have been out there to Rolling Hills.[¶] So I'm—my conclusion is there isn't enough to go to the jury on that issue." We cannot say the trial court erred in this regard.

Moreover, even if Downey's conduct constituted negligence, it would not have exonerated Ohio. Insurance Code section 533 provides that an insurer "is not exonerated

by the negligence of the insured, or of the insured's agents or others." (See also *Pellas v. Ocean Acc. & Guar. Corp.* (1938) 24 Cal.App.2d 528, 535 [75 P.2d 635], which held that negligence by the insured did not preclude coverage under a fidelity bond.)

Buried in Ohio's argument on the improperity of the punitive damage award, which appears as Argument VI in Ohio's opening brief on its cross-appeal, are a number of contentions attacking certain jury instructions. We find no reversible error.

E. PUNITIVE DAMAGES

1. Sufficiency of Evidence to Support Punitive Damage Award

Ohio claims there is no evidentiary support for the Jury's finding that it acted maliciously and in bad faith towards Downey, and thus the jury's award of punitive damages was inappropriate.

On this appeal, we are governed by the familiar substantial-evidence test of *Crawford v. Southern Pacific Co.* (1935) 3 Cal.2d 427 ;0b45 P.2d 183.) Thus, any conflicts in the evidence must be resolved in favor of the respondent, "and all legitimate and reasonable inferences indulged in to uphold the verdict if possible." (*Id.*, at p. 429.) When a verdict is attacked as being unsupported, the power of an appellate court begins and ends with a determination as to whether there is any substantial evidence, contradicted or uncontradicted, which will support the jury's conclusion. (*Ibid.*) Also, when two or more inferences can be reasonably deduced from the facts, the reviewing court may not substitute its deductions for those of the trier of fact. (*Ibid.*) Determinations as to the assessment of punitive damages have traditionally been left to the discretion of the jury. Here, the propriety of punitive damages was also reviewed by the trial court when it rejected Ohio's motion for a new trial and motion for judgment notwithstanding the verdict. (*Egan v. Mutual of Omaha Ins. Co.*

(1979) 24 Cal.3d 809, 821 [169 Cal.Rptr. 691, 620 P.2d 141].)

The law implies a covenant of good faith and fair dealing in every insurance contract. (*Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal. 3d 566, 575 [108 Cal.Tptr. 480, 510 P.2d 1032].) Therefore, when an insurer unreasonably and in bad faith withholds payment on a claim of its insured, it is subject to liability in tort. (*Egan v. Mutual of Omaha Ins. Co., supra,* 24 Cal.3d 809, 818.) An insurer may also breach the covenant of good faith and fair dealing when it fails to properly investigate its insured's claim. (*Id.,* at p. 817.) Under this implied promise, in determining whether to settle a claim, the insurer must give "at least as much consideration to the welfare of its insured as it give to its own interests." (*Id.,* at p. 818.)

Civil Code section 3294 provides: "In an action for the breach of obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant." Though there has been criticism of the concept of punitive damages, the courts in this state have consistently upheld the constitutionality of the punitive-damage statute. (*Egan v. Mutual of Omaha Ins. Co., supra,* 24 Cal.3d 809, 819.) As the state Supreme Court noted in *Egan:* " 'The insurers' obligations are . . . rooted in their status as purveyors of a vital service labeled quasi-public in nature. . . . The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust. [Citation.]' " The court continued: "Furthermore, the relationship of insurer and insured is inherently unbalanced; the adhesive nature of insurance contracts places the insurer in a superior bargaining position. The availability of punitive damages is thus com-

patible with recognition of insurers' underlying public obligations and reflects an attempt to restore balance in the contractual relationship. [Citations.]" (*Id.*, at p. 820.)

Our review of the evidence, which we discussed in detail in our summary of the facts earlier in this opinion, convinces us there was substantial evidence from which the jury could reasonably have found that Ohio "acted maliciously, with an intent to oppress, and in conscious disregard of the rights of its insured," thus entitling Downey to punitive damages. (*Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 923 [148 Cal.Rptr. 389, 582 P.2d 980].)

2. Excessiveness of Punitive Damage Award

Ohio contends the punitive damages are excessive. We examine the evidence on this issue in the light most favorable to the judgment. *Moore v. American United Life Ins. Co.* (1984) 150 Cal.App.3d 610, 636 [147 Cal.Rptr. 878]; *Grimshaw v. Ford Motor Co.* (1981) 119 Cal.App.3d 757, 819 [174 Cal.Rptr. 348].)

The jury awarded Downey $152,983.43 in compensatory damages and $5 million in punitive damages. Calculating the ratio between the punitive and compensatory damages to be 32.7 to 1, Ohio argues the punitive damages are disproportionate to the compensatory damages.

There is no fixed ratio to determine the proper proportion between punitive and compensatory damages. (*Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 636; *Rosener v. Sears, Roebuck & Co.* (1980) 110 Cal.App.3d 740, 751 [168 Cal.Rptr. 237].) The calculation of punitive damages involves, instead, "a fluid process of adding or substracting depending on the nature of the acts and the effect on the parties and the worth of the defendants," and in this regard juries have a wide discretion in determining what is proper. (*Walker v. Signal Companies, Inc.* (1978) 84 Cal.App.3d 982, 998 [149 Cal.Rptr. 119]; *Devlin v. Kearney Mesa AMC/Jeep/Renault, Inc.* (1984) 155 Cal.App.3d 381, 390 [202 Cal.Rptr. 204].)

An examination of cases involving a high ratio between punitive and compensatory damages shows that the punitive damage award in this case is not excessive as a matter of law. Thus, in *Finney v. Lockhart* (1950) 35 Cal.2d 161, 165 [217 P.2d 19], the court upheld a punitive damage award of $2,000 where the compensatory damages award was $1, a ratio of 2000 to 1. In *Neal v. Farmers Ins. Exchange, supra,* 21 Cal.3d 910, the punitive damages awarded were $739,500 and the compensatory damages were $9,500, a ratio of 78:1, which was upheld by the state Supreme Court. And in *Chodos v. Insurance Company of North American* (1981) 126 Ca.App.3d 86 [178 Cal.Rptr. 831], the court upheld an award of $200,000 in punitive damages and $5,146.71 in compensatory damages, a ratio of about 40:1.

"The purpose of punitive damages is to punish wrongdoers and thereby deter the commission of wrongful acts." (*Neal v. Farmers Ins. Exchange, supra,* 21 Cal.3d 910, 928, fn. 13.) The more reprehensible the act, the greater the appropriate punishment. (*Ibid.*) If, as Ohio appears to argue, the overriding consideration in an award of punitive damages is whether it bears a reasonable relationship to the actual damages suffered, the result may thwart the purpose of punitive damages. (*Id.,* at p. 928, fn. 13.) Where, for instance, a defendant's conduct is especially wanton or malicious but the plaintiff's actual damages are low, rigid reliance on the "reasonable relationship" rule would limit the punitive damages to an amount not disproportionate to the actual damages. Such application would in effect ignore the punitive and deterrent functions of exemplary damages. In that situation, a large award of punitive damages would be necessary to ensure that the defendant does not repeat his act and that others do not follow his example. (*Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 637.)

We will not assume that the jury's award of punitive

damages was solely to punish Ohio for its reprehensible conduct towards Downey. The jury could also have intended to punish Ohio for its invidious practices. (See *Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 637.) In this regard, we note it was "standard procedure" for Ohio to instruct its claims adjusters to keep defenses "in the forefront" of the investigation. This was in direct violation of Ohio's duty as an insurer "to give the interests of the insured at least as much consideration as it gives to it own interests." (*Silberg v. Calfornia Life Ins. Co.* (1974) 11 Cal.3d 452, 460 [113 Cal.Rptr. 711, 521 P.2d 1103].) Ohio's own expert testified it was improper to have the investigation focus on the development of facts which would support the insurer's defenses. We also note that Ohio's claims manual instructed its claims personnel to create a "climate for settlement" through the use of depositions "to cause harassment, embarrassment, inconvenience or expense." Here, Ohio scheduled 18 depositions near the time of the mandatory settlement conference set for August 17, 1983.

Since the jury in this case could have reasonably intended to punish Ohio not only for its reprehensive conduct towards Downey but also for its invidious practices, thereby discouraging a repeat thereof, we give the ratio of punitive to compensatory damages little weight. (*Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 637.)

An award of punitive damages will be reversed as excessive only when the entire record viewed most favorably to the judgment indicates the award was the result of passion and prejudice. (*Walker v. Signal Companies, Inc.* (1978) 84 Cal.App.3d 982, 997 [149 Cal.Rptr. 119].) For instance, in *Egan v. Mutual of Omaha Ins. Co., supra,* 24 Cal.3d 809, the court reversed a punitive damage award of 40 times the actual damages of $123,000 on the ground that it was the result of passion and prejudice by the jury toward the plaintiff insured who sued under an individual disability policy. Also, there the award represented 2-1/2

months of the insurer's net annual income, and more than 7 months of its annual income. Unlike the disabled plaintiff in *Egan,* the plaintiff here was not one to arouse the jury's sympathy. In his argument to the jury, Ohio's counsel described Downey as a financially solvent corporate plaintiff with substantial assets. It must be inferred, therefore, that the jury's verdict was not motivated by sympathy for the economic plight of the plaintiff. The trial court's finding, in its denial of Ohio's motion for a new trial, that the jury's award was free from any passion or prejudice and was the product of a "sober" jury further confirms the conclusion that the award was the product of calm and careful deliberations by the jury.

Based on the evidence presented, we cannot say as a matter of law that punitive damages equal to 32 times the award of compensatory damages were unreasonable. (*Devlin v. Kearny Mesa AMC/Jeep/Renault Inc., supra,* 155 Cal.App.3d 381, 390.)

Ohio also contends the punitive damage award was excessive because it represented 1.9 percent of its net worth and 1 percent of the net worth of its parent company.

Wealth is an important consideration in determining the excessiveness of a punitive damage award. Because the purposes of punitive damages are to punish the wrongdoer and to make an example of him, the wealthier the wrongdoer, the larger the award of punitive damages. (*Bertero v. National General Corp.* (1974) 13 Cal.3d 43, 65.) A defendant's net worth is generally considered the best measure of his wealth for the purpose of assessing exemplary damages. (*Devlin v. Kearney Mesa AMC/Jeep/Renault Inc., supra,* 155 Cal.App.3d 381, 391.)

The evidence established that Ohio Casualty Corporation, the parent company, owned 100 percent of the stock of defendant Ohio Casualty Insurance Company and other companies; that these companies occupied the same office space, used the same claims manual and claims handling

procedures, and employed many of the same personnel; and that one consolidated set of financial statements was prepared for these companies. For all intents and purposes, therefore, these companies were one and the same.

In *Moore* v *American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 641, the court upheld a punitive damage award which represented 3.2 percent of the defendant's net assets. Here we cannot say that the proportion of punitive damages to net worth is, as a matter of law, excessive. (*Moore* v. *American United Life Ins. Co., supra,* at p. 642.)

Relying on its net income rather than that of its parent company, Ohio argues that the punitive damage award represents 16.7 percent of its net annual income and is therefore excessive. As we noted earlier, the evidence established that for all intents and purposes the two companies were one. The average net annual income for the period 1978 to 1982 was some $70 million. The jury's award of punitive damages of $5 million represents 3.64 weeks of Ohio's net annual income. In *Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d 610, 642, the court upheld a punitive damage award which represented 3.4 weeks of the defendant's net annual income.

We cannot conclude that, as a matter of law, the punitive damage award in this case is excessive. Also, the jury's award of punitive damages was scrutinized by an experienced trial judge on a motion for a new trial, which was denied. Although a trial court's determination is not binding upon a reviewing court, it is to be given great weight because of the trial court's greater familiarity with the evidence. (*Bertero v. National General Corp., supra,* 13 Cal.3d 43, 64.) Reviewing the record in light of this rule, we cannot conclude the trial court was wrong.

3. Alleged Violations of Eighth and Fourteenth Amendments

Ohio claims the punitive damage award violates the Eighth Amendment's prohibition against the imposition of excessive fines. We have already concluded the award is not excessive as a matter of law. Moreover, the Eighth Amendment applies only to criminal actions, not to purely civil penalties, as involved here. (*Ingraham v. Wright* (1977) 430 U.S. 651, 664 [51 L.Ed. 2d 711, 725-726, 97 S.Ct. 1401]; *Zwick v. Freeman* (2d Cir. 1967) 373 F.2d 110, 119.)

Ohio also contends the punitive damage award was imposed in a civil action " 'unaccompanied by the types of safeguards present in criminal proceedings,' " in violation of the Fourteenth Amendment due process clause. Where, as here, the action is civil in nature, civil rules rather than criminal rules of procedure apply. (*Toole v. Richardson-Merrell Inc.* (1967) 251 Cal.App.2d 689, 717 [Cal.Rptr. 398, 29 A.L.R.3d 988].) Besides, Ohio has failed to identify the "safeguards" it was allegedly denied. We conclude the award of penal damages made under civil rules of procedure did not violate any of Ohio's constitutional rights. (*Toole v. Richardson-Merrell Inc., supra,* at p. 717.)

DISPOSITION

The judgment is affirmed as to Ohio's appeal but reversed as to Downey's appeal.

With respect to Downey's appeal, the judgment is reversed based on the trial court's refusal to allow Downey to recover, as part of its damages, costs and attorney's fees incurred in its lawsuit against Ohio to obtain the benefits of the fidelity bond. (*Brandt v. Superior Court, supra,* 37 Cal.3d 813, 819-820.) On remand, the trial court shall conduct a hearing to determine such fees. Downey is also entitled to attorney's fees on appeal. Although an appellate court may determine such fees, we believe the

trial court on remand will be in a better position to do so. (*Hadley v. Krepel* (1985) 167 Cal.App.3d 677, 687 [214 Cal.Rptr. 461]; *Leaf v. Phil Rauch, Inc.* (1975) 47 Cal.App.3d 371, 379 [120 Cal.Rptr. 749].)

Downey shall recover its cost on appeal.

CERTIFIED FOR PUBLICATION.

KENNARD, J.*

We concur:

KLEIN, P.J.
LUI, J.

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*Assigned by the Chairperson of the Judicial Council.

APPENDIX B

OFFICE OF THE CLERK
COURT OF APPEAL
STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT
CLAY ROBBINS, JR., CLERK

DIVISION: 3 DATE: 03/17/87

Gascou, Gemmill & Thornton Montgomery B009549
1100 Glendon Ave.
Suite 1900
Los Angeles, CA 90024

RE: Downey Savings and Loan Association
vs.
Ohio Casualty Insurance Company
Mcgrew, Dennis
2 Civil B009549
Los Angeles No. C262871

PETITION FOR REHEARING DENIED

APPENDIX C

SUPERIOR COURT OF CALIFORNIA, COUNTY OF LOS ANGELES

C 262 871

DOWNEY SAVINGS AND LOAN ASSOCIATION, a California corporation,

Plaintiff(s)

v.

THE OHIO CASUALTY INSURANCE COMPANY, a corporation

Defendant(s)

FILED

JAN 12 1984

JUDGMENT ON VERDICT IN OPEN COURT (LONG FORM)

This action came on regulation November 17, 1983, in Department 57 the Honorable Paul G. Breckenridge Jr., plaintiff appearing by attorneys Saphier and Rein by Michael S. Saphier and Marvin E. Krakow;

and the defendant appearing by attorneys Montgomery, Gascou, Gemmill & Thornton by George C. Montgomery and Rene J. Gascou, Jr.

A jury of 12 persons was regularly impaneled and sworn to try the action. Witnesses on the part of the plaintiff and the defendant were sworn and examined. After hearing the evidence, the arguments of counsel, and instructions of the Court, the jury (illegible) to consider of their verdict, and subsequently returned into Court, and being called answered to their names and duly rendered their verdict in writing in words and figures as follows

"Title of court and cause" We the jury in the above entitled action find for the plaintiff, Downey Savings and Loan Association, and against the defendant, Ohio Casualty Insurance Company, and assess compensatory damages in the among of $123,769.75.

Answer the following question by placing an "X" in the appropriate box.

1. Shall plaintiff recover punitive damages from defendant?
☐ ☐

If your answer is "No", the Foreman shall sign and date this Verdict form, as the Verdict is complete.
If your answer is "Yes", then answer the next question, and then the Foreman must sign and date your verdict.

JUDGMENT ON VERDICT IN OPEN COURT

2. We assess punitive damages against the defendant, Ohio Casualty Insurance Company, the amount of $5 Million.
DATED January 09, 1984 /s/ Thomas Gibilisco
Foreman

And the Court having heretofore on August 15, 1983, Department 88, granted plaintiff's Motion for Prejudgment Interest.

WHEREFORE, by virtue of the law, and by reason of the promises aforesaid, it is ordered, adjudged, and decreed that said plaintiff, Downey Savings and Loan Association, a California corporation, have and recover from said defendant, The Ohio Casualty Insurance Company, a corporation, compensatory damages in the sum of $123,769.75 plus prejudgment interest on attorneys' fees and costs in the amount of $18,088.18 and $11,125.50 on the settlement for a total of $152,983.43 with interest thereon at the rate of ten per cent per annum from the date of the judgment until paid together with costs and disbursements amounting to the sum of $_____.

Further, that said plaintiff, Downey Savings and Loan Association, a California corporation, have and recover from said defendant, The Ohio Casualty Insurance Company, a corporation,, punitive damages in the sum of Five Million Dollars.

JUDGMENT ON VERDICT IN OPEN COURT

APPENDIX D

ORDER DENYING REVIEW
AFTER JUDGMENT BY THE COURT OF APPEAL
2nd District, Division 3, No. B009549-S000553

IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

IN BANK

DOWNEY SAVINGS AND LOAN ASSOCIATION
v.
THE OHIO CASUALTY INSURANCE COMPANY

FILED
MAY 27 1987

Respondent's petition for review DENIED.

I, LAURENCE P. GILL, Clerk of the Supreme Court of the State of California, do hereby certify that the proceeding is a true copy of an order of this Court, as shown by the records of my office.

Witness my hand and seal of the Court this 27th day of May A.D. 1987

Clerk
By_____
Deputy Clerk

_____Lucas_____
Chief Justice

Supreme Court, U.S.
FILED
AUG 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-159

In the Supreme Court
OF THE
United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

VS.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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No. 87-159

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

VS.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATEMENT OF THE CASE

This is an action for bad faith denial of insurance benefits brought by Downey Savings and Loan Association ("DOWNEY") against The Ohio Casualty Insurance Company ("OHIO"). OHIO's obligations to DOWNEY arose out of a savings and loan blanket bond that it sold to DOWNEY. The bond, in pertinent part, insured against any loss caused by the dishonest act of any employee of DOWNEY (CT 7034-7051). The bond also promised to defend or indemnify DOWNEY for any attorney's fees and costs incurred by DOWNEY in defending any lawsuit brought by a third party that arose

out of the dishonest act of any employee of DOWNEY (CT 7035).

DOWNEY claimed that one of its employees, a branch manager named Dennis McGrew ("McGrew"), participated in a conspiracy to bilk DOWNEY of hundreds of thousands of dollars. DOWNEY further claimed that the dishonest and fraudulent scheme was partially successful and directly resulted in a lawsuit against DOWNEY brought by a company known as American Funding Corporation ("AFC"). In defending the AFC lawsuit, DOWNEY incurred and paid attorney's fees and costs in the sum of $68,779.65 (CT 5156-5159). DOWNEY also paid AFC the sum of $55,000 to settle the AFC lawsuit (CT 5057-5110, 5367). DOWNEY claimed in the case at bar, in pertinent part, that (1) OHIO was obligated to reimburse DOWNEY for the attorney's fees and costs of $68,779.65 and the settlement sum of $55,000, together with prejudgment interest on said sums from the dates they were paid by DOWNEY, and (2) OHIO acted maliciously and in bad faith in connection with its handling and denial of DOWNEY's insurance claim.

The jury's verdict awarded DOWNEY $152,983.43 in compensatory damages and $5,000,000 in punitive damages (CT 4221, 4254-4255).

OHIO filed a motion for judgment notwithstanding the verdict, a motion for new trial and a motion for remittitur of the punitive damages award. On February 28, 1984, after exhaustive briefing and oral argument, the trial judge denied all three motions (CT 4548-4553).

OHIO appealed from the judgment against it. On February 26, 1987, the Court of Appeal of the State of California, Second Appellate District ("California Court of Appeal") filed its unanimous decision in which it

affirmed the jury's verdict in its entirety (Petition, App. A, at 1a-31a). OHIO filed a Petition for Rehearing in the California Court of Appeal which was denied on March 17, 1987 (Petition, App. B, at 32a). OHIO filed a Petition for Review in the California Supreme Court which was denied on May 27, 1987 (Petition, App. D, at 36a).

On May 29, 1987, OHIO filed in the California Court of Appeal a Motion for Stay of Issuance of Remittitur Pending Writ of Certiorari to the United States Supreme Court. That motion was denied, without opinion, on June 15, 1987. On June 17, 1987, OHIO filed an Application for Stay in this Court. On June 19, 1987, that Application was denied, without opinion, by Justice O'Connor. Thereafter, OHIO satisfied the judgment that was entered on the jury's verdict.

COUNTER-STATEMENT OF FACTS

OHIO's statement of facts repeatedly misstates and distorts the evidence that supports the jury's verdict and award of punitive damages. An accurate summary of the salient facts relating to both DOWNEY's fidelity bond claim based on its employee's dishonesty and OHIO's bad faith and malicious handling of DOWNEY's insurance claim is set forth in the opinion of the California Court of Appeal which is reproduced as Appendix A to the Petition for Writ of Certiorari (See Petition, App. A, at 2a-8a and 23a-29a).

It must be emphasized, however, that the jury's $5,000,000 punitive damages award is firmly grounded in the evidence adduced at trial that established that OHIO knowingly and deliberately conceived and engaged in a dishonest claims process that was designed to deny valid claims and take advantage of *all* policyholders. In this

regard, OHIO did the following in order to cheat DOWNEY out of the benefits of its policy:

1. Failed to conduct a reasonable, adequate, complete or good faith investigation. Though OHIO was thoroughly familiar with the requirements for the proper handling of insurance claims, including the requirements of California Insurance Code section 790.03(h)(3) that required OHIO to handle all insurance claims in a prompt, fair and equitable manner and the similar requirements of OHIO's own Claims Manual, OHIO: (a) did not conduct an investigation upon or within a reasonable time after three separate notices of the occurrence were given to it; (b) conducted whatever investigation was made, once it started, in a dilatory and haphazard manner that did not conform to either the requirements of California Insurance Code section 790.03(h)(3) or its own purported policies and procedures; (c) did not attempt to establish whether it was more likely than not that McGrew was dishonest in connection with his conduct that was the subject of DOWNEY's insurance claim and, in this regard, failed to interview McGrew or any of the other persons involved in the transaction; and (d) systematically excluded from its investigation any facts and information that could be of benefit to the insured and support the insured's claim;[1]

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[1]A striking example of such facts and information that were deliberately ignored by OHIO was the sworn testimony of Steven Duane Jones that was received by OHIO on or about October 31, 1977 (CT 4929-4950) that unequivocally fingered McGrew as the "inside man" in the criminal conspiracy (CT 4919-4950; RT 1492:5-1494:10). After reviewing a copy of the transcript of Jones' sworn testimony, OHIO took the incredible position that it did not consider Jones' sworn testimony to be "hard" evidence of dishonesty on McGrew's part, and it did not have to conduct any further investigation or pay the attorney's fees incurred by DOWNEY in defending the AFC

2. Conducted a dishonest and unfair investigation with the express primary purpose of discovering facts that would enable OHIO to defeat the insurance claim in direct violation of OHIO's duty as an insurer "to give the interests of the insured at least as much consideration as it gives to its own interests." *Silberg v. California Life Ins. Co.,* 11 Cal.3d 452, 460, 113 Cal.Rptr. 711, 521 P.2d 1103 (1974). As the California Court of Appeal noted in its opinion (Petition, App. A, at 27a), this conduct was part of OHIO's "standard procedure" for handling insurance claims. In accordance with this claims handling policy and procedure, and with the express knowledge that it would be unreasonable for OHIO to conduct an investigation in a manner that was designed to discover facts to defeat the claim of the insured, OHIO instructed, in writing, its claims manager and claims adjuster to "keep OHIO's defenses against a claim that was or could be asserted by DOWNEY in the forefront of OHIO's investigation" (CT 4864);

3. Created false and fraudulent written documents with the express intent of fabricating defenses to DOWNEY's insurance claim. OHIO created two such fraudulent documents upon forming the opinion that there was the possibility that McGrew was the "inside man" in the fraudulent scheme to defraud DOWNEY of $100,000 and that there was the possibility of a loss that would be covered by the bond, to wit: (a) a letter from OHIO to DOWNEY dated May 29, 1975 that falsely stated that the first notice OHIO received of the occurrence that could lead to liability under the bond was on May 19, 1975 (CT 4858). The purpose of advising DOWNEY of the May 19, 1975 date was to set up OHIO's defense of late notice to a

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lawsuit because it didn't "believe" Jones (CT 4951-4952; RT 1540:20-1542:8, 1901:22-1902:20).

claim under the bond. OHIO knew the May 29, 1975 letter contained false information but did nothing to correct it (Petition, App. A, at 6a); and (b) a report dated September 16, 1975 prepared by OHIO's claims adjuster that falsely stated that an investigator for the District Attorney's office told him that he believed that McGrew was innocent of any wrongdoing or complicity in the criminal scheme (CT 6907-6910; RT 2613:12-24, 2616:12-2617:9). This fraudulent report was prepared by the claims adjuster shortly after he received written instructions to "keep all possible defenses in the forefront of the investigation" (RT 2612:24-2614:14; Petition, App. A, at 7a);

4. Used the right to notice and take depositions for the improper purpose of "harassing, embarrassing, inconveniencing and causing expense" to insureds in order to "create a climate for settlement" pursuant to the written policy set forth in OHIO's Claims Manual (CT 5530; RT 1602:2-1605:25, 1877:21-28; Petition, App. A, at 27a);

5. Knowingly and intentionally applied improper standards for proof of insurance claims. In this regard, OHIO required DOWNEY to obtain a *confession* or *admission of guilt* from McGrew before it would pay DOWNEY's insurance claim (RT 1533:10-1540:11, 1833:1-28, 1837:22-1839:3) even though OHIO knew that it was obligated to pay DOWNEY's fidelity loss once it was established that it was more likely than not that McGrew had committed a dishonest act that resulted in a loss to DOWNEY (RT 1286:17-1827:17; Petition, App. A, at 7a); and

6. Failed to indemnify DOWNEY for its attorney's fees incurred in defending the AFC lawsuit even *after* OHIO knew there was a potential for liability under the policy and had concluded that it had an absolute obligation to do so (RT 1285:26-1287:17, 1771:24-1773:10, 1850:20-24, 1856-A:12-22, 1921:12-21).

It is respectfully submitted that the record in this case is replete with evidence that supports the jury's verdict and explains why (a) the trial court denied OHIO's post trial motions for judgment notwithstanding the verdict, new trial and remittitur, (b) the California Court of Appeal unanimously affirmed the judgment and (c) the California Supreme Court denied OHIO's Petition for Review.

OHIO'S PETITION SHOULD BE DENIED BECAUSE IT DOES NOT PRESENT ANY IMPORTANT QUESTION OF FEDERAL LAW

In an effort to persuade this Court that its petition for writ of certiorari presents an important question of federal law, OHIO has tried to make it appear that the instant case raises the same constitutional issues that are now before the Court in *Bankers Life and Casualty Co. v. Crenshaw,* No. 85-1765 (prob. juris. noted March 9, 1987). OHIO claims, in essence, that the law in California regarding the tort of insurance bad faith and the awarding of punitive damages is virtually identical to the petitioner's version of Mississippi law in *Bankers Life.* OHIO argues that California's civil punitive damages law, like Mississippi's, violates the Eighth and Fourteenth Amendments because it does not contain any standards which limit such awards to reasonable amounts and does not afford civil defendants the protections that are enjoyed by defendants in criminal cases. OHIO also claims that the defendant herein, like the defendant in *Bankers Life*, was subjected to punitive damages on the basis of a newly formulated and retrospectively applied legal standard that governs an insurer's obligations to its insured.

DOWNEY submits that OHIO's attempt to equate this case with *Bankers Life* rests on a distortion of the record,

a misrepresentation of relevant California law, and a fabrication of the issue of the purported newly formulated legal standard concerning the duty owed by an insurer to its insured. The factual record, legal determinations and California law at issue herein are fundamentally different from those in the *Bankers Life* case.[2]

A. The Law of Insurance Bad Faith in California Was Clearly Defined.

In California, an insurer may be subject to liability in tort when it "unreasonably and in bad faith" violates the obligations it owes to an insured. *Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 818-823, 169 Cal.Rptr. 691, 620 P.2d 141 (1979); *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566, 573-574, 108 Cal.Rptr. 480, 510 P.2d 1032 (1973); *Fletcher v. Western National Life Ins. Co.*, 10 Cal.App.3d 376, 401-402, 89 Cal.Rptr. 78 (1970). Such tortious bad faith has been found where, as here, an insurer (a) fails to properly investigate its insured's claim, *Egan v. Mutual of Omaha Ins. Co., supra*; (b) fails to give as much consideration to the welfare of its insured as it gives to its own interests, *Silberg v. California Life Ins. Co., supra; Comunale v. Traders & General Ins. Co.*, 50 Cal.2d 654, 660-661, 328 P.2d 198 (1958); (c) unreasonably and in bad faith withholds payment on a valid claim of its insured, *Egan v. Mutual of Omaha Ins. Co., supra; Gruenberg v. Aetna Ins. Co., supra; Fletcher v. Western National Life Ins. Co., supra*; and (d) in bad faith, breaches its duty to defend or indemnify an insured when

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[2]The denial of OHIO's Application for Stay of execution on the judgment reinforces the conclusion that OHIO's petition does not present any substantial federal question and should be denied. *General Council v. Superior Court*, 439 U.S. 1369, 1373-1374 (1978); *Gregory-Portland Independent School District v. United States*, 448 U.S. 1342 (1980).

there is a potential for liability under the insurance policy, *Gray v. Zurich Insurance Company*, 65 Cal.2d 263, 275-276, 54 Cal.Rptr. 104, 419 P.2d 168 (1966); *CNA Casualty of California v. Seaboard Surety Company*, 176 Cal.App.3d 598, 605-609, 222 Cal.Rptr. 276 (1986).

In California, an insurer's duty to either defend or indemnify an insured for its reasonable attorney's fees and costs incurred in defending a lawsuit arises whenever the insurer ascertains facts from any source which give rise to the potential for liability under the insurance policy. *Gray v. Zurich Insurance Co., supra; Hartford Accident & Indemnity Co. v. Civil Service*, 33 Cal.App.3d 26, 34, 198 Cal.Rptr. 737 (1973); *Lowell v. Maryland Casualty Co.*, 65 Cal.2d 298, 300-302, 54 Cal.Rptr. 116, 419 P.2d 180 (1966); *CNA Casualty of California v. Seaboard Surety Company, supra*. The law in this state has been abundantly clear on this point since *Gray v. Zurich* was decided in 1966. Further, and perhaps most significantly, OHIO at all times had a clear and correct understanding of the applicable California law (RT 1285:26-1287:17, 1771:24-1773:10, 1850:20-24, 1856-A:12-22, 1921:12-22). OHIO's contention that it was penalized pursuant to a newly formulated legal standard that did not exist and to which it could not reasonably have been expected to conform at the time the alleged wrongful conduct occurred is a false and misleading statement of both pertinent California law and its express knowledge and understanding of pertinent California law.[3]

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[3]The trial court ruled on DOWNEY's motion for summary adjudication of the issues that (a) on October 31, 1977, OHIO indisputably was aware of facts which created a potential for liability under the bond and (b) OHIO, therefore, was contractually obligated to indemnify DOWNEY for the attorney's fees incurred in defending the AFC

Moreover, the duty to indemnify contained in the fidelity bond's defense clause required OHIO to *either* (a) defend the AFC lawsuit for DOWNEY through attorneys of OHIO's choice or (b) indemnify DOWNEY for its reasonable attorney's fees and costs incurred in defending the AFC lawsuit (CT 7035; Petition, App. A, at 2a). The defense clause did not relieve OHIO of its unequivocal obligation to provide the insured with a defense at the insurer's expense once it became clear that there was a potential for liability under the insurance policy. Nor did it require the insurer to indemnify the insured for the ultimate loss caused by the dishonest act of the insured's employee. The duty to indemnify contained in the defense clause is thus part of the insurer's duty to provide a defense for the insured rather than part of the separate duty to indemnify once the loss has been incurred and liability has been established.

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lawsuit from that date forward (CT 2709-2711). The compensatory damages award was, in pertinent part, based on this ruling.

By contrast, OHIO's bad faith and malicious conduct upon which the punitive damages award was based included (a) failing to conduct a reasonable, adequate, complete or good faith investigation, (b) conducting a dishonest and unfair investigation with the express primary purpose of discovering facts that would enable OHIO to defeat the insurance claim, (c) creating fraudulent documents in order to fabricate defenses to DOWNEY's insurance claim, (d) using the right to notice and take depositions for the improper purpose of harassing, embarrassing, inconveniencing and causing expense to insureds in order to create a climate for settlement and (e) knowingly and intentionally applying improper standards for the proof of insurance claims. Contrary to the unspoken assumption contained in OHIO's argument, there is no evidence or reason to believe that the jury's punitive damages award was based principally upon OHIO's failure to indemnify DOWNEY for its attorney's fees.

B. The Prerequisites for the Imposition of Punitive Damages in California Were Well-Established.

Before punitive damages can be assessed in an insurance bad faith case in California, there must be a determination, as there was in this case, that the insurer (a) acted wrongfully in violation of a duty it owed to its insured, (b) acted unreasonably (in bad faith) in violating the duty it owed to its insured, *and* (c) acted with oppression, fraud or malice when it violated the duty it owed to its insured.[4] *Egan v. Mutual of Omaha Ins. Co., supra.*

The statutory requirement that the defendant must be found to have acted with oppression, fraud, *or* malice before punitive damages may be awarded is designed to limit the situations in which such damages may be imposed. California courts have consistently held that the statutory standards set forth in California Civil Code section 3294 are not unconstitutionally vague and provide sufficient guidance for the trial courts charged with implementing it. *Bertero v. National General Corp.,* 13 Cal.3d 43, 66, fn. 13, 118 Cal.Rptr. 184, 529 P.2d 608 (1974); *Grimshaw v. Ford Motor Co.*, 119 Cal.App.3d 757, 811-812, 174 Cal.Rptr. 348 (1981); *Zhadan v. Downtown L.A. Motors*, 66 Cal.App.3d 481, 501-502, 136 Cal.Rptr. 132 (1976); *Egan v. Mutual of Omaha Ins. Co., supra,* 24 Cal.3d at 819-820. In the case at bar, the California Court of Appeal expressly held that there was substantial evidence from which the jury could reasonably have found

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[4]California Civil Code section 3294 provides: "In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant."

that OHIO acted maliciously with an intent to oppress *and* in conscious disregard of the rights of its insured, thus entitling DOWNEY to punitive damages (Petition, App. A, at 25a).

C. There Were Reasonable Guidelines in California for Determining the Proper Amount of a Punitive Damages Award.

With respect to determining the amount and the propriety of the amount of a punitive damages award, California law provides that punitive damages must be free from passion or prejudice, and that there is a range of reasonableness for punitive damages that reflects the reprehensibility of the defendant's conduct, the financial condition of the defendant, a reasonable relationship between the actual damages suffered and the punitive damages award, and the need to punish and deter the reoccurrence of the wrongful conduct. *Walker v. Signal Companies, Inc.,* 84 Cal.App.3d 982, 998, 149 Cal.Rptr. 119 (1978); *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc.,* 155 Cal.App.3d 381, 390, 202 Cal.Rptr. 204 (1984); *Neal v. Farmers Ins. Exchange,* 21 Cal.3d 910, 927-929, 148 Cal.Rptr. 389, 582 P.2d 980 (1978); *Bertero v. National General Corp., supra,* 13 Cal.3d at 65; *Moore v. American United Life Ins. Co.,* 150 Cal.App.3d 610, 636-637, 197 Cal.Rptr. 878, *mod.* 151 Cal.App.3d 766a (1984); *Pistorious v. Prudential Insurance Co.,* 123 Cal.App.3d 541, 554, 179 Cal.Rptr. 660 (1981).

In the case at bar, the California Court of Appeal emphasized that the critical factors to be considered in accomplishing the purpose of punitive damages of punishing the defendant and deterring the reoccurrence of the wrongful conduct are (1) the reprehensibility of the conduct of the defendant and (2) the wealth of the defendant. The more reprehensible the conduct of the

defendant, the larger the amount of the punitive damages award must be to accomplish the objectives of such awards; similarly, the wealthier the defendant, the larger the award must be. The California Court of Appeal correctly held that the jury's award of punitive damages was free from passion or prejudice and was justified by the reprehensibility of OHIO's conduct, the wealth of the defendant, the fact that OHIO's "invidious practices" affected other insureds besides DOWNEY, and the need to punish and deter the reoccurrence of the wrongful conduct (Petition, App. A, at 23a-29a).

The evidence also established that the amount of the punitive damages award in the case at bar is reasonably related to the wealth and net worth of OHIO. The punitive damages award represented (1) less than 1% of OHIO's net assets, (2) approximately 3/10ths of 1% of its gross assets, and (3) 3.64 weeks of OHIO's annual net income after payment of taxes (CT 5165-5284; Petition, App. A, at 28a-29a). *Moore v. American United Life Ins. Co., supra,* 150 Cal.App.3d at 642.

An examination of prior cases and the cases collected in the appendix to the opinion in *Devlin v. Kearny Mesa AMC/Jeep/Renault, Inc., supra,* demonstrate that the present award, involving a ratio between punitive and compensatory damages of approximately 32.7:1, is well within the historical framework described in *Devlin* and not excessive as a matter of law when compared to what other California appellate courts have approved. In *Moore v. American United Life. Ins. Co., supra,* for instance, the court of appeal approved a jury award of $2,500,000 in punitive damages and $30,000 in compensatory damages, a ratio of 83:1. The *Moore* court reasoned that a substantial punitive damages award is justified when the jury hears evidence of fraudulent claims practices potentially

affecting numerous insureds other than the plaintiff. *Moore, supra,* 150 Cal.App.3d at 636-637.[5]

OHIO cannot credibly deny that California has well-developed principles and standards governing the tort of insurance bad faith and the imposition of punitive damages. Indeed, the essence of OHIO's arguments in its motions for judgment notwithstanding the verdict, new trial and remittitur, its appeal to the California Court of Appeal and its Petition for Review to the California Supreme Court was that the jury's punitive damages award violated the very standards it now claims did not exist.

Nor does OHIO deny that the jury was instructed in accordance with the above-described guidelines for when punitive damages may be awarded and how the amount shall be determined. In this regard, OHIO did not object to any of the trial court's proposed jury instructions that concerned these matters (RT 3357:4-14, 3409:8-3413:25).

D. The Law in Mississippi Governing Insurance Bad Faith and Punitive Damages is Substantially Different Than the Law in California.

Sprinkled throughout OHIO's petition are references to this Court's note of probable jurisdiction in *Bankers*

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[5]For additional California cases with ratios between punitive and compensatory damages in excess of 32.7:1 in which the appellate courts have affirmed the punitive damages awards as falling within the "range of reasonableness," please see *Neal v. Farmers Ins. Exchange, supra; Wetherbee v. United Ins. Co. of America,* 18 Cal.App.3d 266, 95 Cal.Rptr. 67 (1971); *Chodos v. Insurance Company of North America,* 126 Cal.App.3d 86, 178 Cal.Rptr. 831 (1981); *Delos v. Farmers Group, Inc.,* 93 Cal.App.3d 642, 663-668, 155 Cal.Rptr. 843 (1979); *Finney v. Lockhart,* 35 Cal.2d 161, 217 P.2d 19 (1950).

Life and Casualty Co. v. Crenshaw, supra, and the notion that the instant case raises the same federal questions that are asserted in the *Bankers Life* case. This simply is not true.

The threshold question presented in *Bankers Life* concerns the constitutionality of a Mississippi statute which automatically imposed a mandatory penalty of 15% of the money judgment upon the unsuccessful defendant-appellant, Bankers Life, irrespective of the merit of the appeal and whether or not the appeal was frivolous (See Jurisdictional Statement filed by Bankers Life, App. A, at i). The case at bar does not involve any comparable or similar statute.

Moreover, in Mississippi, in order to assess punitive damages, there need only be a finding that the insurer wrongfully failed to pay a valid insurance claim. By contrast, before punitive damages can be assessed in California there must be findings that (a) the insurer acted wrongfully in violating a duty it owed to its insured, (b) the insurer acted unreasonably (in bad faith) in violating a duty it owed to its insured, *and* (c) the insurer acted with oppression, fraud or malice when it violated a duty it owed to its insured. Indeed, the absence of a requirement that the insured prove that the insurer's wrongful conduct was grossly negligent, reckless, malicious or intentional generated the argument that a different and lesser standard for the imposition of punitive damages was created and applied in the *Bankers Life* bad faith insurance case than was required generally in other civil cases in Mississippi. Unlike the undeveloped and unsettled law of bad faith insurance in Mississippi, the law in California was clearly defined, fair and specific at all material times.

In the instant case, substantial evidence supports the jury's verdict, the trial judge's denial of OHIO's motion for remittitur and the opinion of the California Court of Appeal to the effect that "OHIO acted maliciously, with an intent to oppress, *and* in conscious disregard of the rights of its insured" (Petition, App. A, at 23a-29a). On the other hand, in the *Bankers Life* case, the jury and the Mississippi Supreme Court only found that Bankers Life acted wrongfully in failing to pay Crenshaw's insurance claim. The jury did not find, nor was it required to find under Mississippi law, that Bankers Life acted unreasonably (in bad faith), oppressively *or* maliciously when it handled and failed to pay Crenshaw's insurance claim.

In addition, once it was determined in *Bankers Life* that the imposition of punitive damages was appropriate, the wealth of the defendant was the only criterion the jury was required to consider in determining the amount of the punitive damages award. By contrast, in California the specific guidelines for determining the amount of the punitive damges award included (a) the nature and extent of the reprehensible conduct of the defendant, (b) the financial condition of the defendant, and (c) the ratio between punitive and compensatory damages had to be within a "range of reasonableness." In this regard, the evidence in the instant case established that OHIO adopted and implemented a systematic company and nationwide policy and procedure of denying valid insurance claims. Thus, the case at bar does not involve a mistake, gross negligence or mere reckless decision making in failing to pay an insurance claim. Rather, it involves actual, insidious fraud that permeated the entire claims handling process of the insurance carrier.

Finally, in the *Bankers Life* case, the trial judge erroneously believed and ruled that he did not have the power to

reduce the jury's punitive damages award. Bankers Life argued on appeal that it was denied the right to have the trial judge who was familiar with the evidence dispassionately evaluate the jury's verdict to determine if it was the result of passion or prejudice. In the instant case, the trial judge did dispassionately review the evidence on the defendant's motions for remittitur, judgment notwithstanding the verdict and new trial. He concluded that the punitive damages award was not excessive, was supported by the evidence, was not the product of passion or prejudice and was the product of a "sober" jury (CT 4548-4563; Petition, App. A, at 28a-29a).

In the case at bar, the California Court of Appeal unquestionably recognized its power and duty to reduce excessive punitive damages awards. However, after conducting its own independent review of the record and applying the guidelines for the imposition of punitive damages to the extraordinary facts of this case, the California Court of Appeal determined that the punitive damages award was neither excessive nor the result of passion or prejudice (Petition, App. A, at 23a-29a).

It is ironic that OHIO claims that there were insufficient standards for the imposition of punitive damages in California and that it was denied meaningful appellate review of the punitive damages award. In the Brief of Appellant filed in the Mississippi Supreme Court, Bankers Life cited California as a model of a state that properly defined both the role of an appellate court in reviewing a punitive damages award and the factors to be considered in determining the amount of a punitive damages award (See Jurisdictional Statement filed by Bankers Life, App. A, at 128a and 132a). It is California's well-developed, clearly defined, fair and understandable guidelines for the imposition of punitive damages that sets it

apart from states like Mississippi where the development of bad faith insurance law is in its incipient stages.

E. The California Court of Appeal Properly Concluded that Even if the Excessive Fines Clause of the Eighth Amendment Were Applicable to Civil Punitive Damages Awards, the Instant Award is Not Excessive.

OHIO's argument that the Eighth Amendment applies to civil punitive damages ignores the conclusion of the California Court of Appeal that, even if that were the case, the instant award is not excessive:

> "OHIO claims the punitive damage award violates the Eighth Amendment's prohibition against the imposition of excessive fines. We have already concluded the award is not excessive as a matter of law." Petition, App. A, at 30a.

OHIO's focus on the mathematical ratio between the size of the punitive damages award and the compensatory damages award is, for the purposes of the Eighth Amendment, irrelevant. The sole concern of the Eighth Amendment is whether the penalty is disproportionate to the severity of the misconduct. *Solem v. Helm*, 463 U.S. 277, 284 (1983); *Day v. Woodworth*, 54 U.S. (13 How.) 363, 371 (1851). In *Massachusetts Bonding & Insurance Co. v. United States*, 352 U.S. 128, 133 (1956), the Court emphasized that "[b]y definition, punitive damages are based upon the degree of the defendant's culpability," and specifically recognized the propriety of large punitive damages awards "[w]here the degree of fault is high, but the pecuniary injury slight."

OHIO's argument that the award herein is excessive because violations of California Insurance Code section 790.03(h)(5) are punishable by a maximum monetary fine

of $500 under section 790.07 fails to mention that the fine only applies to proceedings brought by the insurance commissioner for a violation of a cease and desist order. California Insurance Code section 790.07 does not prohibit or limit a victimized insured from recovering his provable compensatory damages (as well as punitive damages) in a bad faith tort action where, as here, the evidence of the insurer's tortious bad faith reveals a scope and pattern of outrageous and flagrant acts that extends well beyond the mere violation of a regulatory statute or breach of an express or implied covenant of an insurance contract.

The punitive damages award in the case at bar was imposed under California's well-established, clearly defined, and reasonable principles and standards that govern (a) the obligations owed by an insurer to its insured, (b) the circumstances under which punitive damages may be awarded, and (c) the determination of the amount of such awards. The instant award was set at an amount which plainly serves to punish OHIO for the manner in which it handled DOWNEY's insurance claim and to discourage the continuation of its invidious claims practices. DOWNEY, therefore, submits that the lower courts properly determined that the punitive damages award herein is not "excessive" under the Eighth Amendment even if it did apply to civil tort actions.

F. The Punitive Damages Award Herein Does Not Violate the Excessive Fines Clause of the Eighth Amendment.

OHIO's broad contention that punitive damages awards in civil tort actions are subject to the Excessive Fines Clause of the Eighth Amendment misconstrues the reach of the Amendment and is unsupported by either

history or judicial precedent.[6] This Court has already examined the history of the Eighth Amendment and concluded that its prohibitions were intended to apply only to criminal proceedings. *Ingraham v. Wright,* 430 U.S. 651, 664-666 (1977); *Solem v. Helm, supra,* 463 U.S. at 284, fn. 8.

Punitive damages awards in civil tort actions are part of the state's remedial system for the enforcement of important rights. *San Francisco Civil Service Ass'n. v. Superior Court of Marin County,* 16 Cal.3d 46, 49-50, 127 Cal.Rptr. 131, 544 P.2d 1331 (1976). As this Court has recognized, "[p]unitive damages have long been a part of traditional state tort law" (*Silkwood v. Kerr-McGee,* 464 U.S. 238, 255 (1984)), and are a system of "wholly private penalties. . . ." that are designed and intended to remedy purely private wrongs. *Kelly v. Robinson,* 479 U.S. ____, 93 L.Ed.2d 216, 229, fn. 13, 107 S.Ct. 353, 361-362, fn. 13 (1986). Because punitive damages have historically been regarded as a civil penalty, and are not imposed in proceedings which bear the attributes of criminal law or which subject the wrongdoer to possible imprisonment or stigmatization associated with a conviction, they do not constitute a criminal penalty subject to the Eighth Amendment. *Ingraham v. Wright, supra.*

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[6]It should also be pointed out that while OHIO asserted numerous affirmative defenses to the Complaint in its Answer (CT 126-143), OHIO did not assert any defense based on Eighth Amendment grounds. OHIO urged this position for the first time on appeal, notwithstanding California's well-established rule against such practice. *Snelson v. Ondulando Highlands Corp.,* 5 Cal.App.3d 243, 259, 85 Cal.Rptr. 806 (1970). Consequently, OHIO's Eighth Amendment argument was not properly raised or decided in accordance with California law and is not properly before this Court. *Ellis v. Dixon,* 348 U.S. 458, 459-464 (1955).

G. OHIO's Argument that It Was Deprived of Due Process of Law Becaue It Was Subjected to Liability and Punitive Damages Under a Standard That Did Not Exist at the Time of OHIO's Wrongful Conduct Is Not Properly Before This Court.

OHIO never relied in the trial court or the California Court of Appeal on the Due Process Clause of the Fourteenth Amendment or any other constitutional provision in support of its claim that an insurer's obligation to indemnify its insured for defense costs is governed under a different or lower standard than the one set forth in *Gray v. Zurich, supra,* and its progeny, and that the application of the *Gray v. Zurich* standard to the obligations OHIO owed to DOWNEY constitutes a new standard that did not previously exist. This argument was made on the basis of and limited to matters of contractual interpretation and state law. OHIO has attempted to recast this argument in constitutional terms in this Court in an effort to force it into the formula used in *Bankers Life* and manufacture a "substantial federal question."

While OHIO did raise a Fourteenth Amendment argument in its trial court pleadings and briefs to the California Court of Appeal, that argument was confined to the claim that OHIO was not afforded the protections available to defendants in criminal proceedings (Petition, App. A, at 30a). Otherwise, OHIO did not identify a single procedural safeguard which it now contends it was denied. In this regard, OHIO did not claim that it was denied constitutionally required fair notice of the rules of procedure or standards of adjudication that governed the obligations it owed to its insureds.

OHIO had ample opportunity to assert its claim in the trial court and before the California Court of Appeal that the application of the standard first enunciated in *Gray v.*

Zurich to its conduct in this case deprived it of Due Process of law. However, OHIO did not object to the trial court's proposed jury instructions on constitutional grounds (CT 4179-4183; RT 3357:4-14, 3409:8-3413:25) and, similarly, did not raise any constitutional complaint about this matter before the California Court of Appeal.[7] Having failed to raise this jury trial issue either at the trial level or in its briefs filed in the California Court of Appeal, OHIO is barred and foreclosed from raising it at this late date. *Snelson v. Ondulando Highlands Corp., supra,* 5 Cal.App.3d at 259.

This Court has repeatedly ruled that it cannot and will not "decide federal constitutional issues raised here for the first time on review of state court decisions." *Cardinale v. Louisiana,* 394 U.S. 437, 438 (1969); *District of Columbia Court of Appeals v. Feldman,* 460 U.S. 462, 482, fn. 16 (1983); *Webb v. Webb,* 451 U.S. 493, 499 (1981). And while the Court has recognized that a party may enlarge upon a particular federal question raised in the lower court, the "enlargement" doctrine does not permit a litigant to raise issues that were not "necessarily connected" to the questions presented below "so that the state court could not have given judgment (on the questions that were raised) without deciding it." *Dewey v. Des Moines,* 173 U.S. 193, 198-199 (1899). The California Court of Appeal decided every question that was raised below without "necessarily" deciding the Due Process

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[7]The sole objection made by OHIO to the proposed jury instructions that relate to an insurer's duty to either defend or indemnify an insured for its defense costs was confined to the erroneous and discredited claim that General Agreement "C" of the fidelity bond only required an insurer to defend or indemnify an insured for defense costs when the third party's complaint alleged a loss that was caused by employee dishonesty (RT 3409:25-3411:13).

question that OHIO now urges in its petition. Accordingly, that question is not properly before this Court.

H. OHIO's Argument that Due Process Requires that Defendants in Civil Tort Actions that Involve Punitive Damages Are Entitled to the Same Procedural Rights That Are Enjoyed by Defendants in Criminal Cases is Frivolous.

OHIO's attempt to persuade this Court that defendants exposed to punitive damages in civil tort actions are entitled to all of the rights afforded defendants in criminal proceedings ignores the fact that this Court has consistently confirmed the constitutionality of punitive damages adjudicated in traditional civil proceedings and has *never* ruled that an award of punitive damages so adjudicated violates the Due Process Clause of the Fourteenth Amendment, the Eighth Amendment, or any other constitutional provision. *Scott v. Donald*, 165 U.S. 58, 68 (1897); *Smith v. Wade*, 461 U.S. 30, 35 (1983).

The cases have uniformly held that an "award of penal damages made under civil rules of procedure (does) not violate any constitutional right" of the party against whom the award is made. *Toole v. Richardson-Merrell, Inc.*, 251 Cal.App.2d 689, 717, 60 Cal.Rptr. 398 (1967); *Curtis Publishing Company v. Butts*, 388 U.S. 130, 159 (1967); *Smith v. Wade, supra; Malandris v. Merrill Lynch, Pierce, Fenner & Smith*, 703 F.2d 1152, 1173 (10th Cir. 1981), *cert. den.* 464 U.S. 824 (1983).

OHIO's challenge to the civil administration of tort actions involving punitive damages also overlooks and ignores the rule developed by this Court that state statutes not involving suspect classifications or impinging on fundamental rights are "presumed to be valid and will be sustained if the classification drawn by the statute is

rationally related to a legitimate state interest." *City of Cleburne v. Cleburne Living Center*, 473 U.S. 432, 440 (1985). See *Williamson v. Lee Optical*, 348 U.S. 483, 488 (1955); *Ferguson v. Skrupa*, 372 U.S. 726, 728-732 (1963). As demonstrated above, California's statutory punitive damages provision, California Civil Code section 3294, constitutes part of the state's remedial system for the enforcement of important rights. The statute and interpreting state court decisions manifest well-established and clearly defined guidelines for the imposition of punitive damages in civil tort actions and are "rationally related" to the historic and legitimate purposes served by punitive damages. Thus, California's civil administration of punitive damages in tort actions comports with Due Process and OHIO is not entitled to convert this civil action into a criminal proceeding.

Moreover, as noted by the California Court of Appeal, OHIO's Due Process argument is defective because OHIO never identified in the courts below a single procedural safeguard which it now contends it was denied (Petition, App. A, at 30a). OHIO did not claim that it was denied an opportunity to be heard, or that traditional notions of fair play were not applied, or that articulated rules of procedure and standards of adjudication were not followed. Rather, OHIO's claim that criminal rules of procedure should be applied to a civil proceeding is simply its Eighth Amendment claim in masquerade. The argument is no more compelling in this guise. Indeed, OHIO's claim that the application of criminal safeguards would prevent excessive punitive damages awards is irrelevant in this case since the lower courts have ruled that the instant award is not excessive in fact or law. Thus, it is unnecessary to even consider OHIO's claim because it would not affect the award in this case.

CONCLUSION

The lower courts applied the well-developed and reasonable standards of California law governing punitive damages to the facts of this case and determined that the punitive damages award in this case was not excessive. In addition, this case does not involve the retrospective imposition of punitive damages under a new cause of action, and OHIO did not properly raise this issue below. Nor does this case involve any statute that imposes a penalty on any person who unsuccessfully appeals an adverse money judgment.

For the foregoing reasons, OHIO's petition for writ of certiorari does not raise any important question of federal law and does not present an "appropriate setting" to consider the constitutional issues referred to in former Chief Justice Burger's concluding comments in *Aetna Life Insurance Company v. Lavoie,* No. 84-1601 (Apr. 22, 1986) slip op., at 13, 106 S.Ct. 1580, 1589 (1986). Accordingly, it is respectfully submitted that the petition for writ of certiorari should be denied.

DATED: August 18, 1987.

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PROOF OF SERVICE BY MAIL

I am a citizen of the United States and a resident of the City and County of Los Angeles; I am over the age of eighteen years and not a party to the within action; my business address is: 1706 Maple Avenue, Los Angeles, California.

On August 18, 1987, I served the within Brief in Opposition to Petition for Writ of Certiorari in re: "The Ohio Casualty Insurance Company vs. Downey Savings and Loan Association" in the United States Supreme Court, October Term 1987, No. 87-159 on the Parties in said action, by placing Three copies thereof enclosed in a sealed envelope with postage fully prepaid, in the United States post office mail box at Los Angeles, California, addressed as follows:

Theodore B. Olson, Esq.
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1050 Connecticut Avenue, N.W.
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All Parties required to be served have been served.

I certify (or declare), under penalty of perjury, that the foregoing is true and correct.

Executed on August 18, 1987, at Los Angeles, California

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Supreme Court, U.S.
FILED
AUG 26 1987
JOSEPH F. SPANIOL, JR.
CLERK

(5)

No. 87-159

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

REPLY MEMORANDUM

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IN THE

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OCTOBER TERM, 1987

No. 87-159

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

REPLY MEMORANDUM

Because the arguments advanced by respondent in its Brief in Opposition ("Br. in Opp.") are largely irrelevant to whether the federal questions presented by petitioner are substantial and warrant plenary consideration by the Court, petitioner's reply will focus narrowly on the few points warranting a reply.

1. The Eighth Amendment Question

The main thrust of respondent's opposition to the Court's plenary consideration of Question 1 presented by petitioner—whether a punitive fine of $5,000,000 is in violation of the Excessive Fines Clause of the Eighth Amendment—is that petitioner's Eighth Amendment argument is incorrect. Respondent initially suggests, Br. in Opp., at 18-19, that the Court of Appeal may have assumed the applicability of the Eighth Amendment to this $5,000,000 award and, on

that assumption, concluded that this award did not violate the Excessive Fines Clause. The Court of Appeal, however, merely determined that the award was not excessive as a matter of state law, Pet. Cert., App. A, 25a-29a, and, in a separate part of its opinion, declined to inquire whether the award was excessive under the Excessive Fines Clause, squarely holding that the Eighth Amendment "applies only to criminal actions . . . ." *Id.*, at 30a. Thus, this case presents both the question whether the Excessive Fines Clause applies generally to punitive damage awards and the question whether the specific award in this case is constitutionally excessive under that Clause.

Respondent also contends that petitioner's argument that the Excessive Fines Clause applies to punitive damage awards is foreclosed by the Court's decisions in, *e.g.*, *Ingraham* v. *Wright*, 430 U.S. 651 (1977). Br. in Opp., at 20. Respondent's claim cannot be reconciled with *Ingraham* itself,[1] with the Court's identification of this question as raising an "important issue" in *Aetna Life Insurance Co.* v. *Lavoie*, 106 S.

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[1] As the *Ingraham* Court indicated, some types of punishment may be regarded as criminal for purposes of the Eighth Amendment even though not expressly labeled as criminal. *Ingraham* v. *Wright*, 430 U.S. 651, 669 n.37 (1977). Respondent asserts, Br. in Opp., at 20, that punitive damages are imposed to remedy "purely private wrongs," but elsewhere maintains that the award in this case was imposed in connection with petitioner's claims process under which petitioner assertedly tried to "take advantage of *all* policy holders." Br. in Opp., at 3. Respondent cannot have it both ways. In California, as elsewhere, punitive damages are not imposed to compensate the plaintiff but to vindicate the public's interest in punishing a wrongdoer and deterring similar conduct.

Ct. 1580, 1589 (1976), or with the Court's implied grant of certiorari to consider this question in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987), 107 S. Ct. 1367 (1987).[2]

Finally, respondent suggests, Br. in Opp., at 20 n.6, that this question—squarely resolved by the Court of Appeal—"is not properly before this Court" because it was raised for the first time in the Court of Appeal. This position is without merit. As the Court has held, if a state appellate court decides a federal question, the state court will be viewed as having "necessarily concluded that the federal constitutional question had been properly presented . . . ." *New Jersey* v. *Portash*, 440 U.S. 450, 455 (1975). In addition, decision of the Eighth Amendment question by the Court of Appeal as the highest state court having exercised jurisdiction over this case pretermits any inquiry into the presentation of that question to the state courts. *E.g.*, *Charleston Federal Savings & Loan Ass'n* v. *Alderson*, 324 U.S. 182, 185-86 (1945).[3] In short, the

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[2] The Court's unrestricted notation of probable jurisdiction constitutes an implied grant of certiorari over the Eighth Amendment question presented in *Bankers Life*. *See, e.g.*, *Gent* v. *Arkansas*, 384 U.S. 937 (1966). Respondent's statement, Br. in Opp., at 8 n.2, that Justice O'Connor's denial of petitioner's Application for Stay of the judgment in this case "reinforces" its position that this case does not present a substantial federal question requiring resolution by the Court is refuted by, *e.g.*, the full Court's similar action in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. A-694 (Apr. 7, 1986), 106 S. Ct. 1509 (1986) (denying Application for Stay).

[3] That the Court of Appeal's decision of the Eighth Amendment issue is dispositive of this issue notwithstanding the refusal of the Supreme Court of California to exercise its discretionary

Court's jurisdiction over this question is governed by the "elementary rule that it is irrelevant to inquire . . . when a Federal question was raised in a court below when it appears that such question was actually considered and decided." *Manhattan Life Insurance Co.* v. *Cohen*, 234 U.S. 123, 124 (1914).[4]

2. Imposition of Liability Under a New Legal Standard

Respondent defends at length, Br. in Opp., at 7-19, California's law of bad faith and punitive damages, suggesting that the "California law at issue herein [is] fundamentally different" from Mississippi's law of bad faith and punitive damages involved in *Bankers Life and Casualty Co.* v. *Crenshaw, supra.* Br. in Opp., at 8. Respondent's observation has no relevance to Questions 1 and 3 as presented by petitioner because Question 1 focuses solely on the size of the punitive damage award, *see* note 4, *supra*, and Question 3 is not presented by the appellant in *Bankers Life.*

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jurisdiction over the case is beyond doubt. *See, e.g., Orr* v. *Orr*, 440 U.S. 286, 274-75 (1979) (decision of federal constitutional question by Alabama Court of Civil Appeals established this Court's jurisdiction notwithstanding action of Supreme Court of Alabama declining to exercise its discretionary jurisdiction over case).

[4] Respondent's suggestion, Br. in Opp., at 9, that this case and *Bankers Life* cannot be "equate[d]" for purposes of petitioner's Eighth Amendment challenge to the excessiveness of the punitive damage award at issue is meritless. It is clear that any decision of the Court in *Bankers Life* holding the Excessive Fines Clause to be applicable to punitive damage awards would affect the award in this case. This constitutional question does not depend for its resolution on the state of the substantive law of bad faith in any particular jurisdiction.

Respondent's observation is equally irrelevant to the substantiality of Question 2. Petitioner's Due Process Clause challenge as framed in Question 2 is narrowly grounded in the fact that until the decision below, no California decision had ever imposed upon the issuer of a fidelity bond the legal obligation to indemnify its insured for defense costs as those costs are incurred. As petitioner demonstrates, Pet. Cert., at 17-18, the only California authority expressly discussing the question *when* an insurer's obligation to indemnify its insured under a fidelity bond for the costs of defense arises, *CNA Casualty of California* v. *Seaboard Surety Co.*, 176 Cal. App. 3d 598, 605, 222 Cal. Rptr. 276, 278-79 (1976), states unequivocally that that obligation arises "after liability is established." Respondent does not deny petitioner's assertion, Pet. Cert., at 7-8, that respondent itself expressly agreed in writing that indemnification for defense costs would "properly" await the termination of the lawsuit brought against respondent by the lender. It is thus clear that petitioner's challenge arises out of the making of new California law by the court below.

Petitioner's position is straightforward: under *Gray* v. *Zurich Insurance Co.*, 65 Cal. 2d 263, 54 Cal. Rptr. 104 (1966), and particularly *CNA Casualty of California* v. *Seaboard Surety Co.*, *supra*, it had a reasonable basis to believe that its obligations under the fidelity bond were materially different from those undertaken by an insurer who assumes a contractual duty to defend in a general liability policy. Pet. Cert., at 17-18. Respondent's assertion, Br. in Opp., at 9, that California's law "has been abundantly clear on this point since *Gray* v. *Zurich* was decided in 1966" glosses over the fundamental distinction between a

fidelity bond, under which the insurer undertakes the obligation to indemnify for defense costs with an option to provide a defense, and the duty under a general liability policy to provide a defense in the first instance. Pet. Cert., at 17-18. Respondent's reliance on *CNA Casualty* to support its position typifies respondent's attempt to obfuscate pertinent California law, since the *CNA* court expressly recognized that the "duty to defend is much broader than the duty to indemnify." 176 Cal. App. 3d, at 605, 222 Cal. Rptr., at 278. *None* of the cases relied upon by respondent other than *CNA* purport to determine *when* the obligation of an insurer to indemnify its insured for defense costs arises in California under a fidelity bond.[5] That the Court of Appeal made new substantive law by which it affirmed petitioner's li-

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[5] In addition to *Gray* v. *Zurich* and *CNA Casualty*, respondent, Br. in Opp., at 9, relies on two other cases for the proposition that petitioner's obligations under the fidelity bond were settled at the time its conduct occurred. One case, *Lowell* v. *Maryland Casualty Co.*, 65 Cal. 2d 298, 54 Cal. Rptr. 116 (1966), decided the same day as *Gray*, involved a comprehensive personal liability policy under which the insurer was held to have a duty to defend based on express language in the policy stating that the insurer "shall defend" against suits brought against the insured "even if such suit is groundless, false or fraudulent." 65 Cal. 2d, at 299-300, 54 Cal. Rptr., at 116-17. The other case, *Hartford Accident & Indemnity Co.* v. *Civil Service Employees Insurance Co.*, 33 Cal. App. 3d 26, 108 Cal. Rptr. 737 (1973), also involved an insurance policy under which it was held that there was a duty to defend "even if such suits were 'groundless, false or fraudulent.'" *Id.*, at 33, 108 Cal. Rptr., at 742. These cases involve insurance policies under which the insurer assumes a "duty to defend"; the fidelity bond at issue here contained no comparable language and, until the decision below, no comparable obligation.

ability for bad faith and, therefore, punitive damages, is not open to serious dispute.[6]

Respondent also argues, Br. in Opp., at 21-23, that this question is not properly before the Court because petitioner did not raise it "at the trial level or in its briefs filed in the California Court of Appeal." Br. in Opp., at 22. This argument is meritless. As petitioner pointed out, Pet. Cert., at 19 n.6, this federal question did not mature until the Court of Appeal had departed from the apparent teaching of *CNA Casualty* by holding that the duty to indemnify for legal costs under a fidelity bond is equivalent to the duty to defend under a general liability policy. In such circumstances, petitioner's reliance, Pet. Cert., at 19 n.6, on the doctrine established by *Brinkerhoff-Faris Trust Co.* v. *Hill*, 281 U.S. 673, 677-78 (1930), under which a federal question arising for the first time as a result of the decision of the highest court of a state may be raised for the first time in this Court, is sufficient. Furthermore, under *Pruneyard Shopping Center* v. *Robins*, 447 U.S. 74, 85-86 n.9 (1980), petitioner was not required to present this federal question to any California court by way of a rehearing petition; petitioner, in any event, *did* present this question to the Supreme Court of California, *see* Pet. Cert., at 19 n.6, as the only California court in a position to

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[6] Respondent expressly concedes that the compensatory damage award in this case for breach of contract "was, in pertinent part, based on this ruling . . . ," Br. in Opp., at 9-10 n.3, but simultaneously suggests that the punitive damage award was not based "principally" upon this ruling. Under petitioner's submission, however, *none* of the punitive damage award may be based on the new rule of substantive law laid down by the Court of Appeal.

resolve the apparent conflict between the decision below and *CNA Casualty*.[7]

3. The Absence of Federal Constitutional Protections Afforded Defendants in Criminal Cases

Arguing that punitive monetary fines imposed solely for the purposes of punishment and deterrence—including the $5,000,000 punitive damage award in this case—may be imposed in a civil action, respondent invokes cases in this Court in which this issue was not presented (*e.g.*, *Smith* v. *Wade*, 461 U.S. 30 (1983)), and a California statute which purports to authorize this practice (*Cal. Civ. Code* §3294 (Deering 1976)). Br. in Opp., at 23-24. Respondent, however, makes no attempt to reconcile its position with the decision in *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144 (1963), relied upon by petitioner, Pet. Cert., at 20, in which the Court struck down a federal statute even though the penalty imposed under that statute served purposes other than punishment and deterrence which might have justified a different result in that case. Under respondent's reasoning, it is *a fortiori* that *Kennedy* could not stand.

Respondent also suggests, Br. in Opp., at 24, that petitioner seeks additional procedural protections be-

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[7] As pointed out by *amicus curiae* California Bankers Association, the California Court of Appeal has routinely upheld the imposition of punitive damage awards in cases, like the instant one, in which liability turned on the resolution of a legal issue of first impression by that court. *See* Br. of the California Bankers Association as Amicus Curiae in Support of the Petition, at 8-9 & n.5. This phenomenon makes the Court's consideration of this question in this case all the more important, because the Court's decision would clearly have a considerable impact on the application by all state courts of new legal standards to sustain punitive damage awards.

cause such protections might result in less excessive punitive damage awards and that, therefore, this question need not be considered because the trial court and Court of Appeal determined that the $5,000,000 award in this case was not "excessive." Petitioner's position, however, is that *no* punitive damages may be imposed in the absence of criminal procedural safeguards because the purposes of punitive damage awards are to punish and deter—the classic purposes of the criminal law. The requirement for such constitutional protections does not depend on the level of punishment imposed particularly where, as here, no meaningful limits have been set by the State on the discretion of juries to punish defendants. Furthermore, and as discussed above, the fact that the $5,000,000 award was determined not to be excessive as a matter of California law says nothing about whether the imposition of *any* punitive damage award comported with the Due Process Clause of the Fourteenth Amendment. The resolution of this question does not depend on the answer to the question whether the award was excessive as a matter of federal or state law.

August 26, 1987

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No. 87-159

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

SUPPLEMENTAL BRIEF OF PETITIONER

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SUPPLEMENTAL BRIEF OF PETITIONER

This Supplemental Brief is filed pursuant to Rule 22.6 of the Court's Rules for the purpose of addressing certain issues raised by this Court's decision on May 16, 1988 in *Bankers Life and Casualty Company* v. *Crenshaw*, No. 85-1765.

A. *Bankers Life* As Applied To Question 1—The Excessive Fines Clause Issue

In *Bankers Life*, the Court concluded "that the appellant's Eighth Amendment challenge, like its other challenges to the size of the punitive damage award, [had not been] properly raised below." Slip op., at 6 (footnote omitted).

This case presents *none* of the jurisdictional problems which led to the Court's decision not to reach the Excessive Fines Clause question in *Bankers Life*. In its appeal to the California Court of Appeal, petitioner explicitly raised a federal constitutional challenge under the Eighth Amendment's Excessive Fines Clause to the size of the punitive damage award. (For the convenience of the Court, pertinent excerpts from the main briefs of petitioner and respondent addressing the Excessive Fines Clause question in the California Court of Appeal are reprinted, in full, in Appendices A and B, respectively, *infra*.) Petitioner's challenge was squarely rejected by the court below based upon a decision of this Court. Pet. Cert., App., at 30a. Thus, it is indisputable that petitioner's Eighth Amendment claim was "raised and passed upon in state court," *Bankers Life*, slip op., at 4, and there is therefore no *jurisdictional* bar to the Court's consideration of that issue in this case.

In *Bankers Life*, the Court articulated several prudential considerations which, in light of the " 'great public im-

portance of the issues involved,' " slip op., at 7, *quoting Illinois* v. *Gates*, 462 U.S. 213, 224 (1983), persuaded the Court not to reach the Excessive Fines Clause question *in that case*. Although the Court's power to reach that issue in the case at bar cannot seriously be disputed, those prudential considerations do not support a declination by the Court to review petitioner's properly presented, important constitutional claims in this case even if those considerations were otherwise thought to be relevant.

1. ***The legislatures of the several States have had ample opportunity to address the injustices associated with unlimited and excessive punitive damage awards.***

In *Bankers Life*, the Court noted the possibility that Mississippi's legislature "might choose to enact legislation addressing punitive damage awards for bad-faith refusal to pay insurance claims . . . ." Slip op., at 7-8 (footnote omitted). Although any state legislature might theoretically enact legislation addressing the size of punitive damage awards at any time, that uncertain contingency provides no basis for declination by this Court to review the substantial constitutional deprivation experienced by petitioner in this case and passed upon by the California courts.

For many years, this Court and individual Justices have, in a series of cases and largely *sua sponte*, articulated substantial concerns regarding the inequities and capriciousness of large, uncontrolled and random punitive fines in civil cases.[1] Scholars and other commentators have been

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[1] *See, e.g., Rosenbloom* v. *Metromedia, Inc.*, 403 U.S. 29, 82 (1971) (Marshall, J., dissenting); *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974); *Electrical Workers* v. *Foust*, 442 U.S. 42, 48 (1979) (Marshall, J.); *Smith* v. *Wade*, 461 U.S. 30, 57-65 (1983) (Rehnquist, J., dissenting); *Dun & Bradstreet, Inc.* v. *Greenmoss Builders, Inc.*, 472 U.S. 749, 780 n.4 (1985) (Brennan, J., dissenting).

expressing similar concerns for decades.[2] Three years ago, in June, 1985, the Court sent an even clearer signal regarding these concerns when it set for argument *Aetna Life Insurance Co.* v. *Lavoie*, 475 U.S. 813 (1986), in which two of the questions presented pressed similar constitutional challenges to the punitive damage system.

On April 22, 1986, in a message that was neither obscure nor equivocal, this Court gave the legislative and judicial branches of the several States an unmistakably clear signal that out-of-control punitive fines in civil cases raised "important" federal constitutional questions under the Excessive Fines Clause, the Due Process Clause and the Contracts Clause that, "in an appropriate setting, *must be resolved.*" *Id.*, at 828-29, (emphasis added). State legislatures do not, of course, resolve such federal constitutional issues; this Court does.[3]

On March 9, 1987, the Court noted probable jurisdiction in *Bankers Life*, thereby again agreeing to consider Excessive Fines, Due Process and Contract Clause federal constitutional challenges to the punitive damage regimes that exist in virtually all jurisdictions. One year later, in determining not to review those questions in *Bankers Life*, the Court for the fourth consecutive year signaled that it regarded those challenges as " 'far-reaching and important.' " Slip op., at 7, *quoting Mishkin* v. *New York*, 383 U.S. 502, 512-13 (1966).

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[2] *See e.g.*, Sales & Cole, *Punitive Damages: A Relic that Has Outlived Its Origins*, 37 Vand. L. Rev. 1117 (1984). Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 So. Cal. L. Rev. 1 (1982); Walther & Plein, *Punitive Damages: A Critical Analysis*, 49 Marq. L. Rev. 369 (1966).

[3] It bears noting here that on January 13, 1986, more than four months prior to the Court's issuance of this warning to the States in *Aetna*, petitioner filed its opening brief in the Court of Appeal presenting these same constitutional issues to that court.

If the Court agrees to review petitioner's essentially identical federal challenges to the constitutionality of the $5,000,000 punitive fine assessed against it, the matter will be briefed, argued and decided during the Court's 1988 Term. By the time any decision could be rendered, state legislatures will have had nearly four years of relatively wide-spread, unambiguous notice that these issues, at some time, "must be resolved."

While fully cognizant of the importance of this Court's discretion over its docket, petitioner respectfully submits that justice cannot be done to petitioner and many other similarly situated litigants if its important constitutional claim is shelved in order to allow state legislatures more time to deal prospectively with a problem which is causing incalculable present injury. Prior to this Court's decision in *Aetna*, petitioner raised and briefed these issues as well and fully as the Court could possibly expect given the novelty of these challenges. *See* App. A, *infra*, at 1a-9a. Respondent joined issue on the merits and the court below resolved this issue against petitioner on the basis of an opinion of this Court which petitioner contends should not preclude the relief it seeks. Respondent has no constitutional entitlement to the $5,000,000 windfall assessed against petitioner. Punitive damages address the wrong to society and should, in theory, be paid to the State, *see Smith* v. *Wade*, 461 U.S. 30, 59 (1983) (Rehnquist, J., dissenting). There are no equities which favor allowing respondent to retain its unearned, extra-compensatory $5,000,000 bounty simply to permit additional opportunity to allow for the remote possibility the California legislature might someday correct the inequities in the punitive damage system for future potential victims of that system.

It would be particularly unjust to allow this petitioner's constitutional claim to go unreviewed. About the time this petition was filed in this Court, another California jury has imposed yet another punitive damage award against petitioner in the amount of $10,000,000. *G. Amador Corp.*

v. *The Ohio Casualty Insurance Company*, No. B 029795 (Cal. Ct. App., 2d Dist., app. filed Aug. 27, 1987). Thus, petitioner is facing $15,000,000 in fines under California's punitive damage system. Neither petitioner nor other victims of California's regime of massive punitive damages, *see* Br. of California Bankers Ass'n as *Amicus Curiae* in Support of Petitioner, should be required to submit to such overpowering burdens without the opportunity for review by this Court of their legitimate and important federal constitutional defenses. The need for this Court's intervention is as urgent as it is obvious.[4]

2. ***The California courts have had ample opportunity to consider constitutional challenges to punitive damage awards as a matter of state and federal law and have consistently rejected such challenges.***

In *Bankers Life*, the Court attached some importance to the Mississippi Supreme Court's having the opportunity to decide the questions of federal law which this Court declined to address. In the case at bar, the California courts have had that opportunity. As noted above, the Excessive Fines Clause question was fully briefed to the Court of Appeal by both petitioner and respondent. That court's cursory response to this "important and difficult" question was possibly based on respondent's assertion in its brief to that court that, "Despite the fact that for more

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[4] State legislatures, no less than state courts, may well continue to ignore the seriousness of the constitutional issues raised by unlimited punitive damage awards because of the perception that this Court's own precedent leaves them free to do so in enacting statutes such as *Cal. Civ. Code* § 3294. The Court of Appeal felt so constrained, as indicated by its reliance on this Court's decision in *Ingraham* v. *Wright*, 430 U.S. 651, 664-66 (1977), said by the Court of Appeal to establish that the Eighth Amendment "applies only to criminal actions . . . ." Pet. Cert., App. A, at 30a. Respondent repeats this talismanic assertion in this Court. Br. in Opp., at 20. As Justice Marshall has observed, such "limiting precedent in this Court inhibits doctrinal development in the States." *Gilliard* v. *Mississippi*, 464 U.S. 867, 870 (1983) (Marshall, J., dissenting from denial of certiorari).

than a century punitive damages awards have consistently survived constitutional assault, [Ohio Casualty] would have this Court completely ignore this unbroken line of precedent." App. B, *infra*, at 10a.

Although not required to do so prior to bringing its federal questions to this Court, petitioner took its federal constitutional claims (as well as myriad state law challenges to this punitive damage award and the system under which it was imposed), to the Supreme Court of California in a Petition for Review. That petition was denied without dissent and, therefore, without any suggestion that the highest court of California or any of its members has any interest in placing controls on the amount of punitive damage awards as a matter of state or federal law. The record in this case is "well-developed": the California legislature has specifically authorized punitive damage awards without setting any limits whatsoever on the size of such awards and the California court system is demonstrably satisfied with, or indifferent to, the constitutional implications of its punitive damage regime.

Furthermore, this case presents an appropriate vehicle for the Court's consideration of the question whether the absence of any limit on the size of punitive damage awards is, without more, a violation of the Eighth Amendment as incorporated by the Due Process Clause of the Fourteenth Amendment or the Due Process Clause *ex proprio vigore*. In its Petition for Review, petitioner expressly argued that the absence of sufficient standards governing the imposition of punitive damages deprived it of its right, under the Due Process Clause of the Fourteenth Amendment and its California counterpart, "to appreciate and evaluate the consequences of its conduct."[5] Respondent has asserted in

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[5] Petitioner argued, Pet. for Rev., at 19:

> This case also presents the question whether under the Due Process Clause of the California Constitution and its counterpart

this Court that the "statutory standards set forth in [§] 3294 are not unconstitutionally vague and provide sufficient guidance for the trial courts charged with implementing it." Br. in Opp., at 11. Yet *Cal. Civ. Code* § 3294, the California statute which authorizes punitive damages, contains *no standard at all* with respect to how much punishment may be imposed on a defendant pursuant to it.

Petitioner submits that it would be manifestly unjust for the Court to deny this petition solely because the Court may prefer to consider these issues first in a case in which a punitive damage award has been imposed pursuant to a state statute expressly limiting the size of such awards. Petitioner invoked both the Excessive Fines Clause and the Due Process Clause of the Fourteenth Amendment in the California courts and its reliance on those guarantees was squarely rejected. If the Court regards the question whether the absence of any limit on punitive damage awards under California law violates the Federal Constitution as one to be addressed prior to decision of petitioner's primary Excessive Fines Clause argument, then that threshold question should be viewed as "essential" to the correct disposition of the Excessive Fines Clause question and should be briefed fully on the merits and reached in this case. *See, e.g., Procunier* v. *Navarette*, 434 U.S. 555, 559-60 n.5 (1978).

B. *Bankers Life* As Applied To Question 2—The Change-in-Standards Issue

In *Bankers Life*, the Court declined to entertain the appellant's challenge under the Contract and Due Process Clauses to the imposition of liability and punishment based

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in the Fourteenth Amendment to the United States Constitution, a punitive damage award may be imposed at all in the total absence of substantive standards in existence at the time the conduct occurred which would have enabled a defendant to appreciate and to evaluate the consequences of its conduct.

upon newly developed legal standards. The Court declined because the appellant's argument in this Court was based on what the Court characterized as a "vague appeal to constitutional principles . . . ." Slip op., at 5. In this case, there was the clearest assertion, at the earliest available opportunity, that the imposition of punitive damages based on a legal standard non-existent at the time petitioner's conduct occurred violated the Due Process Clause of the Fourteenth Amendment.[6]

C. *Bankers Life* As Applied To Question 3—The Procedural Rights Issue

In *Bankers Life*, the appellant had not included among its constitutional challenges the question of what procedures must be observed in connection with the judicial imposition of punitive damage awards. Thus, the Court had no occasion to address that question. Nevertheless, Justice O'Connor, after discussing the clear implications of cases such as *Electrical Workers* v. *Foust*, 442 U.S. 42 (1979), on the award of punitive damages, stated her view that "the Court should scrutinize carefully the procedures under which punitive damages are awarded in civil lawsuits." Slip op., at 3 (O'Connor, J., concurring in part and concurring in the judgment).

Respondent has taken the position in this Court that petitioner's procedural rights argument is "frivolous" or is, in the alternative, petitioner's "Eighth Amendment claim in masquerade." Br. in Opp., at 23, 24. Petitioner's argument, at least as perceived by two members of the

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[6] In the Supreme Court of California, petitioner expressly argued, Pet. for Rev., at 20 (footnote omitted), relying on the dictum in *Aetna Life Insurance Co. v. Lavoie*, *supra*, that no matter how that court resolved

> the conflicting decisions of the lower California courts which bear on this case, the Due Process Clause surely prevents the large imposition of punitive fines on Ohio.

Court, is manifestly not frivolous. And to the extent that the "procedures" argument is suggestive of constitutional issues similar to those embraced in petitioner's Eighth Amendment agrument, it merely illustrates the seamless web of constitutional doubts raised by the governmentally sponsored system of punishment at issue in this case. Indeed, the interplay between the Excessive Fines Clause and the Due Process Clause in this case is consistent with the fact that they are the only two provisions of our Constitution which find their roots directly in Magna Carta. Thus, it is not surprising that they are essentially fungible in the context of a practice—the imposition of punishment in civil actions—which predates Magna Carta and which that instrument of fundamental rights was intended, in part, to regulate.

CONCLUSION

The *Bankers Life* decision constitutes this Court's fourth message that governmentally sponsored punitive damage systems "must" be subjected to constitutional scrutiny by this Court. Petitioner is entitled to have its important and properly raised constitutional objections to this $5,000,000 punitive fine adjudicated by this Court in this case.

May 23, 1988

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APPENDIX

APPENDIX A

[-81-]

VII. THE $5 MILLION PUNITIVE DAMAGE AWARD VIOLATES APPELLANT'S RIGHTS UNDER THE EXCESSIVE FINES CLAUSE OF THE EIGHTH AMENDMENT AND THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT OF THE UNITED STATES CONSTITUTION.

If Downey ultimately prevails in this case, it will receive a windfall which exceeds its actual damages by an amount which would reimburse those damages some 33 times. Downey will receive this bounty not because the legislature of the State of California has determined that such rewards serve some legitimate state purpose, but rather because a jury acting from passion and prejudice, guided by erroneous instructions, has so determined.

This punitive damage award cannot be reconciled with any concept of fairness, rationality or proportionality such as have been imposed on the states of the United States either under the Eighth Amendment or the due process clause of the Fourteenth Amendment.

A. The Excessive Fines Clause of the Eighth Amendment Should be Held to Apply to Punitive Damage Awards in Civil Cases.

The Eighth Amendment expressly prohibits excessive fines. Remarkably, the United States Supreme Court has never had occasion to construe that provision. Under traditional analyses, therefore, the determination whether the excessive fines clause applies to control the punitive damage award in this case requires an examination of the [-82-] origins of the Eighth Amendment and the contemporary construction of the cruel and unusual punishment clause component of that amendment by this court.

It is important to recognize the primary aspect of punitive damage awards which is beyond dispute and which frames the excessive fines clause inquiry.

The purpose of the imposition of the $5 million punitive damage award against Ohio was twofold. First, to punish Ohio for its *oppressive willful* acts and, two, to warn or deter others from *equally reprehensive conduct.*

Ohio submits that some punishments, though not labeled "criminal" by the state, may be sufficiently analogous to criminal punishments in the circumstances in which they are administered to justify application of the Eighth Amendment. [See *Ingraham v. Wright*, 430 U.S. 651, 669 Note 37 (1977).] Further, if the imposition of a large fine such as the $5 million dollars awarded against Ohio in this case in order to punish and deter others is not sufficiently analogous to a criminal punishment for the Eighth Amendment to apply, then some very serious doubt would be cast on the continuing vitality of cases such as *Trop v. Dulles*, 356 U.S. 86 (1958) and *In re Gault*, 387 U.S. 1 (1967), which have been cited by the U.S. Supreme Court as examples of punishment administered in noncriminal proceedings to which the Eighth Amendment is applicable.

The United States Supreme Court recently re-examined the history of the Eighth Amendment and reaffirmed the pertinence of the English experience to questions arising under that amendment. *Solem v. Helm*, 463 U.S. 277, 284-86 (1983); *Ingraham v. Wright*, 430 U.S. at 664-66.

Does the Eighth Amendment apply only to a fine or penalty imposed in a criminal proceeding or does it also apply to a fine or penalty imposed in a civil proceeding where the purpose of such fine or penalty is to punish the defendant and to deter others from engaging in similar conduct? Appellant strongly urges that it does apply in civil proceedings and does apply in the case before this court.

The United States Supreme Court has clearly understood and applied the cruel and unusual punishments clause to reach certain types of [-83-] punishment which have not been imposed in criminal proceedings. Example, *Trop v. Dulles*, 356 U.S. 86 (1958). The same rationale should apply, for even more persuasive reasons, to the excessive fines clause.

Historically, the brief debate on the excessive fines clause in the First Congress, One Annals of Congress 782-83 (Gales and Seaton Eds. 1834), immediately followed the debate in the House over the proposed Fifth Amendment. *Id.*, at 781-82. Because the Fifth Amendment contained clauses that could have been thought to apply outside the context of criminal proceedings, such as the self-incrimination clause, Representative Lawrence proposed, and the House adopted, language to confine that clause "to criminal cases." *Id.*, at 782. If the framers of the Eighth Amendment had intended that its clauses not be applied outside the context of criminal proceedings, then logically a similar amendment could and would have been proposed. Thus, absent a persuasive reason to believe that the framers intended the word "fines" to encompass only monetary penalties assessed in criminal proceedings, and there is none, the presumption is against such a narrow reading and in favor of the reading which is urged by Ohio in the case now before this court.

An analysis of the English experience, similar to that undertaken in *Solem* and *Wright*, both *supra*, is also relevant to the application of the excessive fines clause to punitive damage awards in a fashion not drawn out in those cases. This experience convincingly demonstrates that the sources of our Eighth Amendment, to wit, Magna Carta and the English Bill of Rights—would have applied the principles embodied in the excessive fines clause directly to control punitive damage awards.

Punitive damages under English law, both common and statutory, originated in the same type of actions which were covered by the "excessive amercement" provision of Magna Carta. Pollock and Maitland, in their general discussion of offenses punishable by amercement or imprisonment in Thirteenth Century England set out the origins of "penal and exemplary damages" as follows:

> "Under Edward I, a favorite device of our legislators is that of giving double or treble damages to 'the party grieved'. They have little faith in 'communal accusation' or in any procedure that expects either royal officials or people in general to be [-84-] active in bringing malefactors to justice. More was to be hoped for the man who had suffered . . . and so in a characteristically English fashion, punishment was to be inflicted in the course of civil actions: it took the form of many fold reparation, of penal and exemplary damages." 2 F. Pollock and F. Maitland, *The History of English Law*, 522 (2nd Ed. 1909).

An amercement is similar to a modern day fine. It was the most common criminal sanction in Thirteenth Century England. *See* Pollock and Maitland, *supra*, pp. 513-515, and *Solem*, *supra*, at p. 284, n. 8.

There can be little doubt that double or treble damages awarded as punitive damages were regarded as an amercement under the earliest relevant English law and, therefore, presumptively were controlled by the excessive amercement provision of Magna Carta. As the U.S. Supreme Court observed in *Solem*, *supra*, "these were not hollow guarantees, for the royal courts relied on them to invalidate disproportionate punishments." (463 U.S. at 285).

Ohio submits that the punitive damage award in this case is of the same character as the remedies which were intended to be limited by the linear antecedents of the Eighth Amendment.

Although punitive damages as awarded in the case before this court are relatively recent in the law of American Juris Prudence, there is little doubt that Blackstone would have regarded such damages as falling within the English common law definition of "fine." In Volume 3 of his commentaries, dealing with "private wrongs," Blackstone identifies no less than six instances in which civil actions for damages were maintained by private persons, where, if the plaintiff prevailed, the defendant was required to pay a fine to the Crown. 3 W. Blackstone, *Commentaries on the Law of England*, 118, 138, 179, 188, 398, 402 (1768). Here, the punitive damage award was made to Downey, not the State of California. But as Justice Rehnquist observed in *Smith v. Wade*, 461 U.S. 30 (1983), the purposes of punitive damages are not to right any wrong done to the plaintiff; indeed, Justice Rehnquist noted that, in theory, punitive damages should be paid to the State, not the plaintiff. (*Smith, supra*, at p. 50—Rehnquist, J. dissenting). *See also, Gertz v. Robert Velch, Inc.*, 418 U.S. 323, 351 (1974) ("punitive damages are private fines levied by civil juries").

[-85-] Ohio strongly urges that the $5 million punitive damage award in this case is excessive. In *Solem, supra*, the U.S. Supreme Court was presented with two substantial difficulties in applying the Eighth Amendment which are not present in the case before this court. First, four justices squarely rejected the holding that the cruel and unusual punishments clause incorporated the concept of proportionality as held by the majority. If, however, the excessive fines clause is applicable to the punitive damage award in the case before this court, then it seems indisputable that the appropriate inquiry regarding excessiveness must be an inquiry into proportionality.

Second, an inquiry into proportionality in the context of punitive damages awarded under a judicially created cause of action as here does not involve an intrusion by this court into the delicate balance of federalism which moved

the dissenters in *Solem, supra*, to observe that the proportionality review there was "nothing other than a bald substitution of individual subjective moral values for those of the legislature." *Id.*, at page 314.

Determining whether the award in this case, to wit, $5 million, is disproportionate and, therefore, excessive, is not at all complicated. Ohio was found by a jury to have wrongfully withheld payment of $123,779.65. The only available measure of proportionality is to compare those contract damages with the $5 million punitive damage award. The ratio is about the same as one month bears to three and one-half years, but, more importantly, it is the single largest punitive damage verdict affirmed in an insurance bad faith case to this date.

Other comparisons between the punishment in the case before this court with statutory schemes yield essentially the same result. For example, under R.I.C.O. 18 U.S.C. § 1961-68, a private plaintiff is authorized to bring a civil action (§ 1964) under which treble damages (plus attorneys' fees) may be recovered if the defendant can be shown, among other things, to have engaged in racketeering activity as defined under the code. Last term, the United States Supreme Court, or rather four justices of that Court, expressly observed that R.I.C.O. places defendants in the position of "facing a tremendous financial exposure (producing) a strong interest in settling the dispute." *See Sedima, S.PR.L. v. Imrex Co.*, Nos 84-648 and 84-822, Slip Opinions at 4-5, 53 [-86-] U.S.L.W. 5034, 5041 (July 1, 1985) (Marshal, J., dissenting). Yet this "tremendous financial exposure" pales by comparison the exposure to which Ohio and other insurers are subjected on a routine basis in the State of California. If Ohio had violated R.I.C.O. and caused the same amount of damages as in the case before this court, its penalty would have been $371,338.95 (plus attorney fees) instead of $5 million dollars.

Ohio suggests that this demonstration shows conclusively the excessiveness of the fine in this case and submits to the court that based upon the authorities cited and the background and history of the Eighth Amendment, that the excessive fines clause was intended to and does apply to punitive damages imposed in civil litigation in this state.

B. The $5 Million Punitive Damage Award Violates Appellant's Rights Under the Due Process Clause.

Punitive damages by definition transfer from one litigant to another a monetary recovery "in excess of . . . actual loss." *Scott v. Donald*, 165 U.S. 58, 86 (1897). Under the due process clause, property rights may be affected, or a person punished only after due process has been observed. *Ingraham, supra*, at p. 672.

Ohio submits that the imposition of punitive damages in the case before this court violates the due process clause because it confiscates a large amount of Ohio's property and transforms it into an ordinary monetary windfall to a large financial institution. The occasion for doing so is punishment for acting inconsistently with rules of conduct that have been developed by our judiciary. (Insurance Code 790-.03(h) not being involved in the case before this court).

Punitive damages are by definition arbitrary, capricious, severe and whimsical. It is not at all surprising that various members of our United States Supreme Court have expressed significant concern about the place of punitive damages in our culture, which culture places a high premium on due process of law. For example, in *Electrical Workers v. Foust*, 442 U.S. 42, at 50 (1979). Justice Marshall, on behalf of the majority, pointed out that "because juries are accorded broad discretion as to the imposition and amount of punitive damages . . . the impact of these windfall recoveries is unpredictable and potentially substantial." [-87-] And Justice Marshal [1] went on to state another danger of punitive damages—that they "may be

employed to punish unpopular defendants." *Id.*, at 50-51 Note 14.

Certainly, in the State of California insurance companies are the most unpopular defendants as evidenced by the many, many cases published and unpublished where large punitive damage awards have been imposed.

Punitive damages in California have gotten out of hand insofar as insurance companies are concerned and it is time to take a realistic look at the constitutionality of punitive damages in light of the reality of what is going on in our courts.

In *Smith v. Wade, supra*, Justice Rehnquist, writing for himself, the Chief Justice and Justice Powell, pointed out that punitive damages are generally rationalized on three grounds. First, they are "assessed for the avowed purpose of voting a *punishment* upon the defendant," 461 U.S. at 58 quoting C. McCormick, *Law of Damages*, 275 (1935) (emphasis added by Rehnquist, J.), but such a punitive fine—if it should be imposed in a civil trial at all—"should go to the state, not to the plaintiff—who by hypothesis is fully compensated." *Id.*, at page 59.

Second, Justice Rehnquist observed that punitive damages are justified as deterring "persons from violating the rights of others." *Id.*, at page 58. Where a known rule of conduct is violated, as was the situation in *Smith v. Wade, supra*, itself, the "deterrence" rationale perhaps would provide some arguably rational basis for a state's authorizing the recovery of a reasonable amount of punitive damages by a private person. Much the same as the State of California has done in the medical malpractice field.

Finally, Justice Rehnquist observed that punitive damages have been "justified as a 'bounty' that encourages private lawsuits seeking to assert legal right." *Id.* It is, however, inconceivable that California's interest in encouraging what amounts to bounty hunters lawsuits against

insurance companies bears any rational relationship to the $5 million awarded in this case.

The fundamental defects in the process afforded to Ohio in this case must be considered in the context of the fact that this punitive damage [-88-] award was imposed in a civil action "unaccompanied by the types of safeguards present in criminal proceedings." *Smith, supra,* at page 59 (Rehnquist, J., dissenting). At the very least, this absence of safeguards strongly supports the U.S. Supreme Court's applying the excessive fines clause or the due process clause with proper vigor to control the imposition of punitive damages awarded. Failure of this court to do so could be contrary to the thrust of U.S. Supreme Court cases which have already placed limits on the power of government to impose punishment on persons in civil litigation. See, for example, *United States v. Ward,* 448 U.S. 242, 248-51 (1980) and cases cited therein. These limitations particularly as they affect the size of punitive damage awards would preserve the constitutional rights of litigants while, at the same time, permitting the State of California appropriate leeway to insure adequate compensation for wrongs committed within this jurisdiction.

APPENDIX B

[-41-]

B. The Constitutional Propriety Of Punitive Damages Is Beyond Dispute.

The propriety of punitive damages is well-established in English and American law. In California, common law authority for punitive damages has been enhanced by the statutory authority of Civil Code section 3294. Despite the fact that for more than a century punitive damages awards have consistently survived constitutional assault, OHIO would have this Court completely ignore this unbroken line of precedent.

DOWNEY submits that OHIO's constitutional attack should be summarily rejected. California courts have consistently held that an "award of penal damages made under civil rules of procedure (does) not violate any constitutional right" of the party against whom the award is made. *Toole v. Richardson-Merrel, Inc.*, (1967) 251 Cal. App.2d 689, 717, 60 Cal. Rptr. 398; and *Wetherbee v. United Insurance Company of America, supra* at 18 Cal.App.3d 272.

Recently, the court in *Grimshaw v. Ford Motor Company, supra* at 119 Cal.App.3d 757, 807 and 811, affirmed the historical and legal inviolability of the doctrine of punitive damages in the following language:

> "The concept of punitive damages is rooted in the English common law and is a settled principle of the common law of this country. (Citations omitted). The doctrine was a part of the common law of this state long before the Civil Code was adopted. (Citations omitted).
>
> • • •

[-42-]

> [The] contention that the statute (Civil Code section 3294) is unconstitutional has been repeatedly rejected. (Citations omitted)."

Nearly a century ago, the United States Supreme Court noted that a great number of judicial decisions had confirmed the constitutionality of punitive damages:

> "It is a well-established principle of the common law that, in . . . all actions on the case for torts, a jury may inflict what are called exemplary, punitive, or vindictive damages upon a defendant. . . . We are aware that the propriety of this doctrine has been questioned by some writers, but if repeated judicial decisions for more than a century are to be received as the best exposition of what the law is, the question will not admit of argument." *Scott v. Donald*, (1897) 165 U.S. 58, 68, 41 L.Ed. 632, 175 S.Ct. 265, quoting *Day v. Wodworth* (1852) 54 U.S. (13 How.) 363, 371.

DOWNEY submits that nothing has changed in the last one hundred years except the publication of even more decisions rejecting these constitutional attacks.

C. The Eighth Amendment Does Not Apply To Civil Actions.

1. The Eighth Amendment Applies To Criminal Actions.

OHIO has advanced the untenable argument that punitive damages are criminal "fines" as envisioned by the Eighth Amendment which provides that "[e]xcessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." OHIO's meandering and frequently inaccurate discussion of the Eighth Amendment does not overcome the obvious and well-established fact that *it applies only to criminal actions.*

OHIO contends at page 82 of its Opening Brief that "some punishments, though not labeled 'criminal' by the

state, may be sufficiently analogous to criminal punishments" to justify application of the Eighth Amendment. However, the cases cited by OHIO are obviously distinguishable and do not contain any authority for OHIO's position that punitive damages are criminal punishments. In fact, the cases hold to the contrary.

OHIO relies on *Ingraham v. Wright* (1977) 430 U.S. 651, 51 L.Ed.2d 711, 97 S.Ct. 1401, for the general proposition that some civil punishments are criminal. *Ingraham* stands for no such proposition. In fact, its holding was to *not extend Eighth Amendment coverage to non-criminal proceedings*:

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> "Bail, fines and punishment traditionally have been associated with the criminal process, and by subjecting the three to parallel limitations the text of the Amendment suggests an intention to limit the power of those entrusted with the criminal-law function of government. An examination of the history of the Amendment and the decisions of this Court construing the proscription against cruel and unusual punishment confirms that it was designed to protect those convicted of crimes. We adhere to this long-standing limitation. . . ." *Id.*, 664.

The Court in *Ingraham* did not consider the applicability of the Eighth Amendment to punitive damages. It did, however, reiterate the long-standing rule that the scope of the Amendment is limited to criminal proceedings. If any lesson can be learned from *Ingraham*, it is that the Supreme Court's refusal to extend Eighth Amendment protection to corporal punishment in public schools, which is conceptually closer to a "criminal" punishment than civil punitive damages, is an indictment of OHIO's argument.

OHIO's reliance on *Trop v. Dulles* (1958) 356 U.S. 86, 2 L.Ed.2d 630, 78 S.Ct. 590, is similarly misplaced. In

Trop, the Court held only that denationalizatin of a citizen as a punishment is improper. In doing so, the Court "recognized that any statute decreeing some adversity as a consequence of certain conduct may have both a penal and non-penal effect." *Id.*, 96. The Court reasoned that loss of citizenship by reason of one's court-martial conviction for wartime desertion was actually a criminal sanction. The narrow and distinguishable holding of *Trop* is misconstrued by OHIO.

OHIO has also misapprehended the holding in *In Re Gault* (1967) 387 U.S. 1, 18 L.Ed.2d 527, 87 S.Ct. 1428. In *Gault*, the Court merely determined that a juvenile who was committed to a detention facility for up to six years without notice to his parents, within one day of being taken into custody, without the complainant's presence at the hearing, with no sworn testimony, and without having been advised of his rights had been deprived of his due process rights. The Court did not pass on the applicability of the Eighth Amendment, but confined its holding to a determination that the Fourteenth Amendment imposes certain safeguards when the State seeks to commit a juvenile to an institution for delinquency. The proximity of that situation to the typical criminal proceeding is obvious. Among other similarities, in both cases the State is the plaintiff and the accused stands to lose his freedom. The *Gault* situation, and the *Trop* situation for that matter, is a far cry from the instant one.

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Even when characteristics which are associated with the criminal process are present, most notably, the government occupying the position of "plaintiff" to enforce a particular statute, the courts are able to distinguish that which is criminal and that which is civil. In *Bell v. Wolfish* (1979) 441 U.S. 520, 60 L.Ed.2d 447, 99 S.Ct. 1861, for instance, the Court held that pretrial detention was not a "penal" sanction, but merely a valid regulatory restraint.

The Court determined that while such detention may interfere with one's "desire to live as comfortably as possible and with as little restraint as possible during confinement," it "does not convert the conditions or restrictions of detention in to 'punishment.' " *Id.*, 537. Accordingly, the Court did not invoke the Eighth Amendment. Surely if actual confinement by the government in connection with a pending criminal proceeding is not a criminal punishment under the Eighth Amendment, civil punitive damages awards cannot be characterized as such.

In *United States v. Stangland* (7th Cir. 1957) 242 F.2d 843, 848, the court held that the United States government's suit to recover statutory penalties for exceeding farm marketing quotas was a suit "to recover civil penalties; consequently, the Eighth Amendment argument is inapposite." In *Zwick v. Freeman* (2d Cir. 1967) 373 F.2d 110, 119, *cert. den.* 289 U.S. 835, the court rejected a constitutional argument similar to that raised in *Stangland* by observing that while Eighth Amendment "protection may have been extended beyond technically criminal sanctions to those criminal in nature (citing *Trop v. Dulles, supra*), it is not applicable to purely civil penalties."

In *United States v. Johnson* (W.D.Mo. 1968) 284 F.Supp. 273, 278 *aff'd* 410 F.2d 38, *cert. den.* 396 U.S. 822, the court found that a defendant could be convicted of a statutory offense and remain liable to the government for civil penalties prescribed by the statute. The court held that the imposition of criminal and civil penalties did not subject the defendant to excessive fines under the Eighth Amendment. If an action by the government itself to recover fines for violations of the law does not constitute a criminal proceeding under the Eighth Amendment, then a civil action for punitive damages by a private litigant clearly is not a proceeding which is criminal in nature. This proposition was reaffirmed in *Dalton v. Bob Neill Pontiac, Inc.* (M.D.N.C. 1979) 476 F.Supp. 789, 797, fn. 13, *aff'd*, 628 F.2d 1348, where the court flatly stated that

the Eighth Amendment's prohibition against excessive fines is only "applicable to those convicted of crimes."

Because of the dearth of authority in support of its position, and the wealth of authority against it, OHIO has chosen to rely on dicta, and dissenting and [-45-] minority opinions in cases which are irrelevant or inapposite. For instance, OHIO relies on *Gertz v. Robert Welch, Inc.* (1974) 418 U.S. 323, 41 L.Ed.2d 789, 94 S.Ct. 2997, for the proposition that "punitive damages are private fines levied by civil juries." This passage is dictum which was used to explain the Court's narrow holding that "a private defamation plaintiff who establishes liability under a less demanding standard than that stated by New York Times (v. Sullivan) may recover only" actual damages. *Id.*, 350. Contrary to being an attack on punitive damages, this passage and the rest of the decision affirm the propriety of awarding punitive damages in cases where a defamation plaintiff proves knowledge of falsity or reckless disregard for the truth.

In its citation of *Smith v. Wade* (1983) 461 U.S. 30, 75 L.Ed.2d 632, 103 S.Ct. 1625. OHIO elects to completely disregard the majority opinion that upholds an award of punitive damages under 42 U.S.C. § 1983 where evil motive or reckless indifference to the rights of others is proven. Instead, OHIO relies on Justice Rehnquist's dissenting opinion which, while reflecting the justice's unfavorable predisposition toward punitive damages in general, states that punitive damages under the statute would be appropriate if improper motive were established. In effect, even this dissenting opinion recognizes the validity of punitive damages.

OHIO's review of the historical underpinnings of the Eighth Amendment, complete with speculation as to how Blackstone would regard punitive damages were he thrust into this century, is inaccurate as well as irrelevant. One need look no further than the United States Supreme Court

opinion in *Ingraham v. Wright, supra,* for evidence of OHIO's specious reasoning. That opinion traces the historical antecedents of the Eighth Amendment and it concludes that "the exclusive concern of the English version (of the Eighth Amendment) was the conduct of judges in enforcing the criminal law." *Id.*, 665. The Court further explored the development of the English version:

> "Although the reference to 'criminal cases' was eliminated from the final draft [of the English version], . . . the deletion was without substantive significance. Thus, Blackstone treated each of the provision's three prohibitions [excessive bail, excessive fines and illegal punishments] as bearing only on criminal proceedings and judgments." *Ibid.*

The *Ingraham* Court went on to discuss the development of the American version of this rule:

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> "But if the American provision was intended to restrain government more broadly than its English model, the subject to which it was intended to apply—the criminal process—was the same." *Id.*, 666.

The *Ingraham* the Court held that the Eighth Amendment is "inapplicable" outside the criminal process. Accordingly, the Court found no reason to wrench the Eighth Amendment from its historical context by extending its coverage to non-criminal matters. *Id.*, 669.

In *Solem v. Helm* (1983) 463 U.S. 277, 290, 77 L.Ed.2d 637, 103 S.Ct. 3001, the Court determined whether a particular prison sentence was cruel and unusual punishment by applying the rule that the punishment must be proportional to the crime. The dissimilarity of *Solem* to the case at bench is apparent even to OHIO who admits at

page 85 of its Opening Brief that the two are completely distinguishable.

In short, OHIO's argument that the Eighth Amendment applies to civil damages is unsupported by history, judicial precedent and common sense. OHIO has advanced no support for its position. The only cases on point hold that the Eighth Amendment is not applicable to civil damages. The courts have not had any difficulty in distinguishing between that which is "criminal" and therefore within the scope of the Eighth Amendment, and that which is "civil" and therefore outside its protections. Punitive damages are clearly in the latter category.

2. Assuming Arguendo That The Eighth Amendment Does Apply To Civil Actions, The Issue Of "Excessiveness" Of The Damages Is A Question Of Fact For The Trier Of Fact.

Even if it be assumed, *arguendo*, that the Eighth Amendment applies to civil punitive damages, it prohibits only "excessive" fines. Consequently, the issue of whether or not the subject award of punitive damages is excessive is for the trier of fact to determine. *Zhadan v. Downtown L.A. Motors* (1976) 66 Cal.App.3d 481, 496, 136 Cal.Rptr. 132. Moreover, the trier of fact has adequate guidelines and standards for making such a determination under Civil Code section 3294. As demonstrated in the preceding sections of this brief, the award of punitive damages in the case at bar is consistent with these accepted standards.

D. OHIO's Fourteenth Amendment Due Process Rights Are Not Violated By The Punitive Damages Award.

OHIO's claim that the punitive damages award violates its due process rights under the Fourteenth Amendment is, in actuality, not a claim of violation of due process at all. OHIO does not identify a single procedural [-47-] safeguard which it contends it was denied. OHIO does not claim that it was denied an opportunity to be heard, or that traditional notions of fair play were not applied, or

that articulated rules of procedure and standards of adjudication were not followed. Rather, OHIO is once again urging that criminal rules of procedure be applied to a civil proceeding. In other words, OHIO's due process claims are simply its Eighth Amendment claim in masquerade. They are no more compelling in this guise.

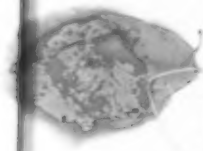
Initially, OHIO has advanced not a single authority for the proposition that punitive damages awarded pursuant to civil rules offend the Fourteenth Amendment's due process clause. That is because there is no such authority. Moreover, the foregoing discussion regarding the overall constitutionality of punitive damages makes it clear that such due process arguments have been rejected each time they have been asserted. *See, Scott v. Donald, supra; Toole v. Richardon-Merrell, Inc., supra;* and *Grimshaw v. Ford Motor Co., supra.*

OHIO misstates the holding in *International Brotherhood of Electrical Workers v. Foust* (1979) 442 U.S. 42, 60 L.Ed.2d 698, 99 S.Ct. 2121. What OHIO characterizes as a broadside levelled at the notion of punitive damages in general is actually nothing more than a narrow holding that punitive "damages may not be assessed against a union that breaches its duty of fair representation by failing properly to pursue a grievance." *Id.*, 52. The relationship of *Foust* to the instant case is nonexistent.

OHIO relies on the dissenting opinion in *Smith v. Wade, supra*, for support of its argument. It has already been established that *Smith* is distinguishable and, to the extent it is relevant, it upholds the validity of punitive damages. However, OHIO does not even place itself within the rationale of the dissent on which it relies. In this regard, OHIO concedes at page 87 of its Opening Brief that the deterrent effect of punitive damages is valid and provides a "rational basis" for the recovery of punitive damages.

OHIO's claim that punitive damages are barratrous is unrelated to the issue of due process. In the first place,

the unfounded assertion that the prospect of punitive damages may encourage some litigants to pursue lawsuits is immaterial to whether or not such damages are proper. In the second place, such an assertion has no bearing on the constitutionality of such damages in general, or on the purported and unnamed fundamental defects in the process afforded to OHIO in this case.



In essence, OHIO is simply contending, without benefit of reasoned analysis or precedent, that the types of safeguards present in criminal [-48-] proceedings should be applied to civil suits. OHIO has also dressed up straightforward arguments regarding the size of the award herein in constitutional raiment. Upon scrutiny, these constitutional pretensions peel away and OHIO's claims are reduced to no more than an attack on the size of the punitive damages award. That issue is discussed at length elsewhere in this brief, and it is sufficient to say that it falls far short of a denial of due process of the law.

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AUG 21 1987

No. 87-159

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of California, Second Appellate District

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION

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MOTION FOR LEAVE TO FILE BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION

The California Bankers Association ("CBA") hereby moves, pursuant to Rule 36.1 of the Rules of this Court, for leave to file the attached brief *amicus curiae* in support of the petition for writ of certiorari. Consent to the filing of this brief has been obtained from petitioner. Respondent has refused consent.

CBA is the statewide trade association for the commercial banking industry in California. Its membership con-

sists of nearly all of the more than 450 commercial banks in the State of California, including 164 banks chartered by the United States. An important aspect of CBA's activities is presenting its members' views on issues involving banking interests before all branches of the state and federal government. Toward that end, CBA has filed *amicus curiae* briefs in this Court in a number of cases affecting the commercial banking industry.

The case before the Court raises significant issues concerning the procedural safeguards required by the Eighth Amendment's prohibition against excessive fines and by the due process clause of the Fourteenth Amendment in actions involving punitive damage claims. Specifically at issue is whether these safeguards should protect defendants in civil actions where it is increasingly common for large fines to be imposed for punitive purposes.

The California Supreme Court's denial of review leaves standing a holding by the California Court of Appeal that the Eighth Amendment applies only in criminal prosecutions and that due process does not require any additional safeguards in civil cases involving determinations of whether and how great a punitive damage award will be imposed. The major consequence of the decision below will be to permit discretionary punitive damage assessments by juries, with virtually no effective protections against arbitrary, prejudicial, and excessive awards.

The members of CBA have increasingly been subjected to ever larger punitive damage awards in California and are directly affected by the decision. *Amicus* is concerned that these awards, which are subject to only limited review, and which frequently involve issues of first impression concerning common practices of commercial banks, threaten the stability of the banking industry and undermine the ability of financial institutions to protect deposits and finance economic development. CBA, moreover, is particularly able to present to the Court the views of an important segment of the business community on the

issues presented in this case and to offer a broader perspective than that provided by the parties before the Court. As a result, CBA requests permission to submit its views on these important issues.

WHEREFORE, CBA respectfully requests that this motion be granted.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 87-159

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeal of California, Second Appellate District

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BRIEF OF THE CALIFORNIA BANKERS ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF THE PETITION

INTEREST OF THE AMICUS

The California Bankers Association ("CBA") respectfully refers the Court to the description of its interest presented in its accompanying Motion for Leave to File Brief.

REASONS FOR GRANTING THE WRIT

Petitioner Ohio Casualty Insurance Co. seeks review after the California Supreme Court denied review of a California Court of Appeal affirmance of a $5 million punitive damage award against an insurance company for a failure to pay a claim that the jury determined

caused approximately $153,000 in actual losses to respondent, the plaintiff. Petitioner argues that the punitive assessment (1) is grossly excessive, in contravention of the "Excessive Fines" Clause of the Eighth Amendment; (2) was sustained on the basis of a substantive legal standard non-existent at the time the alleged wrongful conduct occurred, and (3) was not imposed through a procedure that is minimally consistent with fundamental fairness and was therefore violative of due process safeguards of the Fourteenth Amendment.

Although this Court has stated that these issues are "important" and "in an appropriate setting, must be resolved," these issues have not yet been decided. Indeed, the Court has never decided even the threshold issue of whether the constitutional provisions invoked in this case impose even minimal limits on punitive assessments in civil cases.[1] Review is timely, in light of the sharp in-

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[1] In *Aetna Life Insurance Co.* v. *Lavoie*, 106 S. Ct. 1580, 1589 (1986), this Court acknowledged that the issue of punitive damages is ripe for review, stating that the defendants' arguments that "a $3.5 million punitive damage award is impermissible under the Excessive Fines Clause of the Eighth Amendment; and that lack of sufficient standards governing punitive damage awards in Alabama violates the Due Process Clause of the Fourteenth Amendment . . . raise important issues which, in an appropriate setting, must be resolved." Amicus respectfully submits that this case offers an appropriate vehicle for this Court to address these important issues.

The question of whether the Eighth Amendment applies to punitive assessments is presently before the Court in *Bankers Life and Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987). The instant case presents, in addition to Eighth Amendment arguments, clear issues concerning the requirements under the Fourteenth Amendment that due process be accorded defendants subject to punitive assessments. Moreover, the instant case raises these issues in the context of an action by a corporate, rather than an individual plaintiff, thereby focusing the case squarely on the broad policy implications of the recent explosion in the size and frequency of punitive assessments. It therefore provides a basis for fuller examination of punitive assessments than *Crenshaw*.

crease in the size and frequency of such punitive assessments and the recent expansion of tort law into previously unaffected areas of commerce, resulting in enormous actual and potential liability of major businesses, including financial institutions. Indeed, the costs of such punitive assessments constitute a detriment not only to such institutions, but to customers and the community at large. As a consequence of recent changes, the harm posed by any constitutional defect in the procedures governing punitive damage awards is severe. Even if due process did not historically require special safeguards for punitive assessments, the explosion of punitive damage awards in California and elsewhere demonstrates that such safeguards are necessary today to guarantee that the factual and legal issues raised in punitive damage actions are resolved fairly.

ARGUMENT

California courts have witnessed a recent sharp increase in both the incidence and size of punitive damage awards, precipitated in large part by what has been called the "tortification of contract," *i.e.*, the creation of tort remedies for what once were simple breach of contract cases. Excessive punitive damage awards threaten the continued economic stability of critical institutions, especially commercial banks. Yet, under current practice, there is no effective check on the discretion of juries to assess damages.

In California, "punitive" or "exemplary" damage are expressly intended by statute and case law to *punish*. Indeed, they typically exceed criminal penalties for comparable conduct, in terms of both the amount of monetary penalty and the stigma accompanying the assessment of such fines.[2]

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[2] The maximum monetary sanction in the present case, if the court had found the petitioner wilfully violated an existing order prohibiting it from failing "in good faith . . . [to] effectuate prompt, fair and equitable settlements of claims" pursuant to the California

To be sure, a state may choose to implement its public policy by authorizing such punitive assessments in private "civil" suits. At a minimum, however, such assessments should be subject to the safeguards of the Excessive Fines Clause and the Due Process Clause of the Fourteenth Amendment, just as a fine in a criminal case would be subject to such safeguards.

I. CALIFORNIA, LIKE THE NATION, HAS WITNESSED AN UNPRECEDENTED INCREASE IN THE INCIDENCE AND SIZE OF PUNITIVE ASSESSMENTS

Large punitive damage awards have recently and suddenly become pervasive and commonplace. They have, moreover, become the focus of searching criticism by the courts and the legal community.[3] More than ever before,

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Insurance Code, would have been $500. Cal. Insur. Code § 790.03 (h) (5) (Deering 1976). The punitive assessment in the present case was thus 10,000 times greater than the maximum fine for analogous conduct.

Another example of the dramatic discrepancy between statutorily prescribed fines and discretionary punitive assessments appears in *Bankers Life & Casualty Co.* v. *Crenshaw*, No. 85-1765 (prob. juris. noted Mar. 9, 1987). In *Crenshaw*, a Mississippi case involving allegedly unfair insurance practices, in which the jury had arrived at a punitive assessment of $1.6 million, had the appellant been convicted in the courts of Mississippi under the analogous criminal provisions, the maximum fine that could have been assessed was $1,000. Miss. Code Ann. § 83-5-85 (1972).

[3] *See, e.g.*, Ellis, *Fairness and Efficiency in the Law of Punitive Damages*, 56 So. Cal. L. Rev. 1 (1982); Grass, *The Penal Dimensions of Punitive Damages*, 12 Hastings Const. L. Q. 241 (1985); Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 Va. L. Rev. 139 (1986); Owen, *Problems in Assessing Punitive Damages Against Manufacturers of Defective Products*, 49 U. Chi. L. Rev. 1 (1982); M. Peterson, S. Sarma & M. Shanley, *Punitive Damages: Empirical Findings* (RAND Corp., Institute for Civil Justice, 1987); Seltzer, *Punitive Damages in Mass Tort Litigation: Addressing the Problems of Fairness, Efficiency and Control*, 52 Ford. L. Rev. 37 (1983); Shulkin, *Mass Liability and Punitive Damages Overkill*, 30 Hastings L. J. 1797 (1979); Wheeler, *The*

it is important for this Court to review current procedure and outline at least the minimal constitutional safeguards for imposing punitive assessments.

A. Recent Cases Against Banks in California Are Typical of the Recent Trend in Punitive Damage Awards

Three punitive assessments in the first six months of 1987, totalling nearly $100 million against three different California banks illustrate the scope and magnitude of the issue.

1. In *Stanghellini Ranch Inc.* v. *Bank of America*, No. 35448 (Sutter County Superior Court, April 28, 1987), a farming corporation, and three individuals (the owner of Stanghellini Ranches, and two members of his family liable as borrowers and guarantors of the corporation's debt) brought an action against Bank of America, based on a claim that the bank had fraudulently lent money to a farm, expecting that it would not be repaid, in order to gain control of the farm's assets. The plaintiffs sued on a variety of theories, including fraud and constructive fraud. They contended that Bank of America had "induced" the corporation to borrow increasingly large sums of money, and had persuaded the individuals to guarantee the loans, knowing that the corporation would eventually default. They alleged that the bank did this in order to assume control of the assets of the corporation. The plaintiffs also sued for damages for emotional distress, purportedly suffered when they eventually realized the nature of the Bank's alleged fraud. After finding for the plaintiffs on the fraud and emotional distress allegations, the jury assessed compensatory dam-

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Constitutional Case for Reforming Punitive Damages Procedures, 69 Va. L. Rev. 269 (1983); Ghiardi & Kircher, *Punitive Damages Law and Practice* (1985). *See also Rosenbloom* v. *Metromedia*, 403 U.S. 29, 84 (1971) (Marshall, J., dissenting); *Rosener* v. *Sears, Roebuck & Co.*, 110 Cal. App. 3d 740, 759, 168 Cal. Rptr. 237, *appeal dismissed*, 450 U.S. 1051 (1981) (Elkington, J., concurring).

ages of $20 million, and added a $30 million assessment in punitive damages.

2. In *Bank of California, N.A.* v. *California Land & Equipment Leasing Co., Inc.*, No. 305952 (Sacramento County Superior Court, June 24, 1987), ten investors in various farming partnerships organized by California Land & Equipment Leasing Co. ("Cal Land") and its principals cross-complained against Bank of California after it sued to collect loans it had made to Cal Land. Investors alleged that the bank had concealed from them information concerning misuse of the loans by Cal Land and its principals and in so doing had breached duties of disclosure and good faith. Bank of California denied that it had concealed information from the investors and argued that it owed them no duties whatever, as it had no contractual or other relationship with them. The jury awarded $3.7 million in compensatory damages and $22.6 million in a punitive assessment.

3. In *Conlan* v. *Wells Fargo Bank*, No. 82852 (Monterey County Superior Court, June 11, 1987), the plaintiffs, a farming general partnership and its managing partner, brought an action against Wells Fargo Bank alleging that the bank wrongfully terminated its loans to the farming operation and refused to provide further crop financing. At the time the bank made the decision not to advance further financing, it had determined that the plaintiffs had sustained over $2 million in losses and that the operation was not creditworthy. Moreover, the parties had agreed that if losses reached that figure, the bank could refuse any further financing. After the bank declared a default by the plaintiffs on their debt of approximately $4.5 million to the bank, the plaintiffs brought an action against the bank alleging, *inter alia*, that the bank had originally induced the plaintiffs to enter into the credit agreements through fraudulent representations, that it breached its agreement by declaring the plaintiffs in default, and that it breached the implied covenant of good

faith and fair dealing arising from the bank's purported "special relationship" to its debtor when it terminated the plaintiffs' credit and accelerated the debt. Finding for the plaintiffs, the jury awarded $10 million in compensatory damages, and $50 million in punitive damages. An affidavit of a juror in support of the defendants' motion for a new trial affords a rare insight into the jury process. According to the affidavit, jurors stated that the damages should include amounts to "teach the Bank a lesson," to pay for the plaintiffs' attorneys' fees, and to "give plaintiffs enough money so that they would not have to borrow money again." [4]

B. New Developments in California Tort Law Have Contributed to a Steep Increase in Punitive Damage Awards

As these cases suggest, California has witnessed a revision of the traditional principles of contractual liability—a process that has been termed the "tortification of contract." M. Peterson, S. Sarma & M. Shanley, *Punitive Damages: Empirical Findings* (1987) iv. Until recently, California tort and contract remedies remained distinct, as at common law. Remedies for breach of contract were primarily compensatory, though parties could stipulate to payment of attorneys' fees. Punitive assessments were available only in tort actions, as specifically articulated

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[4] The trend is by no means limited to California. In *Robinson* v. *McAllen State Bank*, No. C-1948-84-D (Texas 206th Dist. Ct., May 12, 1987), the plaintiffs brought an action against the Texas Commerce Bank alleging misrepresentation and breach of the duty of good faith and fair dealing to its loan customers. The plaintiffs had borrowed from the bank on two different occasions to finance construction of a furniture warehouse and showroom, in each case using a plot of land as security for the loans. After the plaintiffs paid off the second, smaller loan, the bank refused to release the deed of trust on the second plot of land, claiming it was part of the security on the first loan. Finding for the plaintiffs, the jury awarded them $59.2 million, including a $50 million punitive assessment against the Texas Commerce Bank.

in California Civil Code Section 3294, which provides in relevant part that "[i]n an action for the breach of an obligation *not arising from contract*, where the defendant has been guilty of oppression, fraud, or malice, the plaintiff, in addition to actual damages, may recover damages for the sake of example and by way of punishing the defendant." Cal. Civ. Code § 3294, subd. (a) (Deering Supp. 1986) (emphasis added).

Recently, however, plaintiffs alleging the breach of certain types of contract have been afforded the right to sue in tort, and thus to demand punitive damages for conduct formerly considered merely contractual. This development has its origin in the holding that insurance companies have a "special duty" to policy holders, who purchase insurance not for financial gain, but to secure "peace of mind." *See, e.g., Crisci* v. *Security Insurance Co.*, 66 Cal. 2d 425, 431-33, 58 Cal. Rptr. 13 (1967); *Gruenberg* v. *Aetna Insurance Co.*, 9 Cal. 3d 566, 573-74, 108 Cal. Rptr. 480, 510 P.2d 980 (1973); *Neal* v. *Farmers Insurance Exchange*, 21 Cal. 3d 910, 920-21, 148 Cal. Rptr. 389, 582 P.2d 980 (1978). This principle was then extended to protect long-time employees terminated without good cause, *Cleary* v. *American Airlines, Inc.*, 111 Cal. App. 3d 443, 168 Cal. Rptr. 722 (1980), to penalize parties to contracts who seek to shield themselves from liability by denying in bad faith the existence of a contract, *Seaman's Direct Buying Service, Inc.* v. *Standard Oil Co.*, 36 Cal. 3d 752, 206 Cal. Rptr. 354, 686 P.2d 1158 (1984), and, most recently, to allow certain bank depositors to recover punitive assessments. *See Commercial Cotton Co.* v. *United California Bank*, 163 Cal. App. 3d 511, 209 Cal. Rptr. 551 (1985) (affirming a $100,000 punitive damage award and compensatory damages of $4,000 imposed against a bank for having, on advice of counsel, refused to reimburse an account for a debit on grounds found later to have been spurious); *Barrett* v. *Bank of America*, 183 Cal. App. 3d 1362, 229 Cal. Rptr. 16 (1986) (holding that the relationship of a bank to its

loan customers is at least "quasi-fiduciary," giving rise to a duty of disclosure of facts that may place the bank at an advantage vis-à-vis the customer). As the recent cases summarized above indicate, this transformation is now virtually complete, for it is commonplace in California for banks to be sued for punitive damages by borrowers—corporate and otherwise—on the theory that the lender acted in bad faith.[5]

C. The Recent Increase in Punitive Assessments Against Defendants Has Been Dramatic

The financial implications of this breakdown in traditional distinctions between contract and tort law have been dramatic. A recent study by the Institute for Civil Justice shows that in the 1980s, since the expansion of tort remedies in California, one-third of punitive damage awards imposed in cases based on claims of breach of contract stemmed from allegations of bad faith on the part of a corporate defendant. M. Peterson, S. Sarma & M. Shanley, *Punitive Damages: Empirical Findings* (1987) ("Rand Study") vi-x, 19-24. Between 1960 and 1984, the number of awards in business tort and breach of contract cases tripled. Between 1980 and 1984, bad faith claims comprised one-fourth of all punitive damage awards. Amounts of damages also increased greatly, with punitive damages in bad faith actions against businesses accounting for almost half of all dollars awarded as punitive damages during that four-year period. The median punitive damage in bad faith actions was $336,000, but the average of such awards was considerably higher, particularly in Los Angeles, where bad faith punitive awards averaged over $3 million. Rand Study at vi-vii.

The Rand Study attributes the explosion in punitive damages since 1960 in large part to expansion of tort

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[5] Both the *Commercial Cotton* and *Barrett* cases involved legal issues of first impression and yet punitive damages were still permitted.

liability against insurance companies, employers, and other businesses traditionally immune to punitive damages for breach of contract. As a result, recent years have seen a sharp upward trend in the size of both extraordinary and routine punitive damage awards, with the greatest rise occurring against businesses in bad faith claims, and the dollar sum of the largest awards increasing most dramatically. Rand Study at ix.

Similarly, insurance sources report that between 1983 and 1985, California courts entered thirty-eight punitive damage awards in excess of one million dollars. In the first half of 1985 alone, five California juries entered punitive damage awards totalling $242 million. J. Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 Va. L. Rev. 139, 145 (1986).

The crushing impact of punitive damage awards against banks has been consistent with that trend. Consequently, vast sums have flowed into private hands, as plaintiffs have received windfall punitive damage assessments, thus increasing the risk for depositors of bank insolvency and discouraging banks from financing new business ventures.[6]

II. EIGHTH AMENDMENT AND DUE PROCESS SAFEGUARDS SHOULD BE APPLICABLE TO PUNITIVE DAMAGE AWARDS

In order to promote its public policy, a state must be free to punish and stigmatize wrongdoers and to use punitive assessments to that end. At the same time, such punishment and stigmatization of wrongdoers should be subject to at least minimal constitutional safeguards, as

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[6] Thus, in the recent case *International Weighing Systems* v. *Bank of Redlands*, No. 220127 (San Bernardino County Superior Court, July 26, 1987), a jury assessed $3.6 million in punitive damages along with a $1.1 million compensatory award, resulting in a judgment against the bank amounting to 40% of its capital. If finally enforced, this punitive assessment will undoubtedly result in the insolvency of the bank.

are other means of penalizing conduct. Both the Eighth Amendment prohibition against "excessive fines" and the Fourteenth Amendment's requirement of due process should limit the imposition of such penalties.

A. Punitive Assessments in California are Penal

Punitive assessments in California are imposed for the express statutory purposes of punishment and deterrence. California Civil Code Section 3294 states that such awards are to be imposed "for the sake of example and by way of punishing the defendant." The California Supreme Court has emphasized that "[t]he purpose of punitive damages is to punish wrongdoers and thereby deter the commission of wrongful acts." *Neal* v. *Farmers Insurance Exchange, supra*, 21 Cal. 3d at 928 n.13; *see also Egan* v. *Mutual of Omaha Insurance Co.*, 24 Cal. 3d 809, 820, 169 Cal. Rptr. 691, 620 P.2d 141 (1979), *cert. denied* and *appeal dismissed*, 445 U.S. 912 (1980); *Evans* v. *Gibson*, 220 Cal. 476, 490, 31 P.2d 389 (1934).

Standard jury instructions approved by the California Judicial Council, an official judicial body, reflect the penal purpose of punitive damages. Informed that punitive damages are "for the sake of example and by way of punishment," jurors are instructed to consider three factors in setting the amount of damages: the reprehensibility of the defendant's conduct, the amount of punitive damages that will have a deterrent effect in light of the defendant's financial condition, and the amount of compensatory damages. 2 *California Jury Instructions—Civil, Book of Approved Jury Instructions* ("BAJI") No. 14.71 (1986 Revision) (App. A).

Properly conceived, therefore, punitive damages are not strictly "damages" at all, but are imposed as penalties, as the Civil Code puts it, "for the sake of example and by way of punishing the defendant." Defendants are meant to be made "examples," *i.e.*, stigmatized, and the publicity attendant to a punitive assessment typically ensures this goal. Defendants are also meant to be "pun-

ished" and the amounts imposed do so, even more so than criminal fines, which are typically many times less severe. *See* Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269, 280-81 (1983). In short, punitive damages in California are intended to be and are penal in character.

B. The Eighth Amendment Prohibition Against Excessive Fines and Requirement of Proportionality Review Should Apply Equally to Civil and Criminal Punishments

It is difficult to understand why, as the Court of Appeal has effectively held in this case, a $100 fine can be imposed in a "criminal" case only after a full panoply of constitutional safeguards but a $10 million punitive assessment in a "civil case," expressly made for purposes of punishment and stigmatization, can be inflicted without regard to any such safeguards. Because such civil and criminal punishments are equivalent in their aim and their effect on defendants, they should be subject to equivalent limits.

The Eighth Amendment stands for the "principle that a punishment should be proportionate to the crime." *Solem* v. *Helm*, 463 U.S. 277, 284 (1982).[7] A state should not be permitted to escape this principle by labelling its punishment as merely "civil."

Accordingly, this Court has recognized that certain forms of punishment must be treated as criminal under

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[7] The Eighth Amendment provides that "[e]xcessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted." U.S. Const., amend. VIII. By contrast to other Bill of Rights provisions, such as the Fifth Amendment, stating that "no person shall be held to answer for a capital, or otherwise infamous *crime* unless on a presentment or Indictment of a Grand Jury," (emphasis added) and the Sixth Amendment, made applicable to "all *criminal* prosecutions," (emphasis added) there is no language limiting the prohibition against excessive fines to criminal proceedings.

the Eighth Amendment, although not explicitly designated as criminal. *Ingraham* v. *Wright*, 430 U.S. 651, 669 n.37 ("Some punishments, though not labeled 'criminal' by the State, may be sufficiently analogous to criminal punishments in the circumstances in which they are administered to justify application of the Eighth Amendment").

In *Kennedy* v. *Mendoza-Martinez*, 372 U.S. 144, 168-69 (1963), this Court formulated a seven-part test for determining when a civil penalty should be governed by criminal procedural safeguards.[8] That test should be used for evaluating punitive damage awards and for determining when criminal procedural safeguards, including the Eighth Amendment's prohibition against excessive fines, should adhere. As shown by the standard BAJI instruction routinely used in California (App. A), as well as by the governing statutory and case law, punitive assessments in California meet virtually all of those factors: (1) they have historically been regarded as punishment and the statute authorizing them expressly so states (Civil Code § 3294); (2) they require a finding of intent to oppress that is comparable to "scienter"; (3) they are used to exact retribution and deterrence, *i.e.*, as the Civil Code states, they are imposed "for the sake of example and by way of punishing the defendant"; (4) much of the conduct subject to punitive damages is made criminal by other statutes; and (5) California ascribes no alternative purpose apart from punishment and example to punitive damages. *See* Jeffries, *A Comment on*

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[8] The relevant factors are: "Whether the sanction involves an affirmative disability or restraint, whether it has historically been regarded as a punishment, whether it comes into play only on a finding of scienter, whether its operation will promote the traditional aims of punishment—retribution and deterrence, whether the behavior to which it applies is already a crime, whether an alternative purpose to which it may rationally be connected is assignable for it, and whether it appears excessive in relation to the alternative purpose assigned . . . ." *Id.*

the Constitutionality of Punitive Damages, 72 Va. L. Rev. 139, 150-51 (1986); Wheeler, *The Constitutional Case for Reforming Punitive Damages Procedures*, 69 Va. L. Rev. 269, 349 (1983).

If this Court agrees that punitive assessments are penal in character, and therefore subject to the limits of the Eighth Amendment, then the proportionality test of *Solem* v. *Helm*, 463 U.S. 277 (1983), is applicable. In *Solem*, this Court looked to three factors in assessing the proportionality of a criminal sentence: "(i) the gravity of the offense and the harshness of the penalty; (ii) the sentences imposed on other criminals in the same jurisdiction; and (iii) the sentences imposed for commission of the same crime in other jurisdictions." *Id.* at 292. By this means, courts imposing punishments are held to an objective standard in setting fines or other punishment and the danger of excessive penalties is minimized.

California's standard jury instruction requires an altogether different standard, one that is incongruous with the Eighth Amendment test articulated in *Solem*. First, it requires that the jury consider "the amount of punitive damages which will have a deterrent effect on the defendant in light of defendant's financial condition." (App. A.) Thus, rather than measuring proportionality by requiring that civil defendants be assessed the same penalty for the same conduct, as the second factor of the *Solem* test dictates, the BAJI instruction *requires* juries to impose larger penalties against wealthier defendants. As the Rand Study and the recent bank cases discussed above reveal, penalties against corporate defendants can prove to be literally millions of dollars greater than the penalty for comparable conduct that might be assessed against an individual defendant. Second, the BAJI instruction requires that "the punitive damages must bear a reasonable relation to the actual damages." (App. A.) This, again, is inconsistent with the Eighth Amendment requirements this Court outlined in *Solem*: The BAJI in-

struction requires the jury to gear the amount of punitive damages to the actual damages assessed, completely ignoring the requirement in *Solem* that penalties imposed in criminal cases for the same conduct be taken into account.

Moreover, California judges are unable to correct jury assessments unless they find "passion or prejudice." *See Bertero* v. *National General Corp.*, 13 Cal. 3d 43, 65 n.12, 118 Cal. Rptr. 184, 529 P.2d 608 (1974). Application of *Solem* to cases involving punitive assessments would correct that lack of review by requiring that the court undertake a proportionality analysis under the Eighth Amendment.

B. Due Process Requires Procedural Safeguards in Punitive Damage Assessments

Before a jury can assess punitive damages, it must first find the defendant "guilty of oppression, fraud or malice" (BAJI No. 14.71, App. A). Yet it is precisely such a predicate that is likely to excite a jury's passion and prejudice, and thus precisely such circumstances in which safeguards against runaway assessments are most needed. There are very few purported limits at present. A California jury is merely instructed that the law "leaves the amount [of punitive damages] to the jury's sound discretion, exercised without passion or prejudice." (BAJI No. 14.71, App. A.) In arriving at the amount, the jury is told to consider the "reprehensibility of the conduct of the defendant," the amount that will "have a deterrent effect on the defendant in light of the defendant's financial condition [which, for financial institutions is usually substantial], and that the amount "must bear a reasonable relation to actual damages" (App. A).

A jury inflamed by reprehensible conduct to begin with will, of course, be inclined favorably to the standard jury argument that, in light of the vast assets of a bank defendant, it is necessary for the jury to impose a large

penalty in order to "teach the bank a lesson." As one California lawyer observed, commenting on the recent spate of successful lawsuits by customers against financial institutions, ' "Jurors themselves are bedeviled by banks . . . and they're ready to swing.' " *Private Courts, Bank Bashing and Zsa Zsa: Convening Lawyers Find Plenty to Discuss*, Wall St. J., Aug. 12, 1987, section 2, at 21, col. 5. The standard jury instruction actually encourages large awards in such circumstances. Moreover, as one commentator has remarked,

> Decisions by trial judges remitting damages awarded by juries are no less the result of visceral reaction than the juries' original awards. And the law is significantly blank on the standards which courts should apply in assessing the awards .... The official reports of later decisions contain no standards and little reasoning; rather certain dollar amounts are sustained and others disallowed. Little more than a rule of thumb governing the upper limits on damages can be ascertained from the cases.

Goodman & Seaton, *California Supreme Court—Forward: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court*, 62 Cal. L. Rev. 309, 350 (1974). As the recent California actions against banks demonstrate, the broad discretion conferred on the jury leaves their deliberations readily susceptible to impulsive judgments, particularly in light of the vagueness of the substantive criteria for punitive damage awards and the governing burden of proof, which requires only a finding for plaintiff by the preponderance of the evidence. Moreover, there are no statutorily defined limits and no fixed or suggested ratio to guide a jury in determining what is a "reasonable relation" between compensatory and punitive damages. Thus, in *Commercial Cotton Co.* v. *United California Bank*, *supra*, 163 Cal. App. 3d at 518, the court affirmed a $100,000 punitive assessment imposed in addition to $4,000 in compensatory damages, a ratio of 25 to 1.

Such vast discretion in such volatile circumstances invites great abuse. Jury discretion, as in criminal sentencing, "must be suitably directed and limited so as to minimize the risk of wholly arbitrary and capricious action." *Gregg* v. *Georgia*, 428 U.S. 153, 189 (1976). We believe the Court should consider the following safeguards.

1. *Due Process Requires Proof by Clear and Convincing Evidence*

This Court has applied the three-pronged test articulated in *Mathews* v. *Eldridge*, 424 U.S. 319 (1976), to determine whether due process requires proof by "clear and convincing evidence" in certain types of cases. The *Eldridge* factors are: "First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail." *Id.* at 335.[9]

Clearly, punitive damages require a higher burden of proof under this standard: *First*, the interest at stake consists of both the property interest of defendants subject to frequently massive punitive damage awards and the stigma that attends a finding of malicious and oppressive conduct. *Second*, the value of additional safeguards to minimize the risk to a defendant's interests is substantial. In the case of an error in imposing punitive

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[9] *See, e.g., Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323 (1974) (holding that clear and convincing evidence is required in certain defamation actions); *Santosky* v. *Kramer*, 455 U.S. 745 (1982) (clear and convincing evidence is required to dissolve the parent-child relationship); and *Addington* v. *Texas*, 441 U.S. 418 (1979) (clear and convincing evidence is required to commit a person involuntarily to a mental hospital).

damages, the defendant stands to lose both property and reputation. On the other hand, in the case of an error in refusing to award punitive damages, the plaintiff, whose right to be made whole is unaffected, loses only the windfall of a sanction aimed to vindicate not his own but the public interest. *Third*, the government has no substantial interest in retaining the preponderance of the evidence standard. This Court has already stressed that "the States have no substantial interest in securing for plaintiffs . . . gratuitous awards of money damages far in excess of any actual injury." *Gertz* v. *Robert Welch, Inc.*, *supra*, 418 U.S. at 349. Moreover, the state's interest in deterring improper conduct is not undermined by raising the burden of proof as to punitive damages. Even in the case of error, a defendant required to pay compensatory but not punitive damages is likely to be deterred, to that extent, from repeating the conduct that resulted in liability.

2. *Due Process Requires Strict Guidelines for Juries Assessing Punitive Damages*

Unlike compensatory damages, in which the size of the award is determined by the extent of injury proved, or penal fines, in which the size of the fine is limited by statute, punitive assessments are left to a jury's discretion and virtually no guidance is provided. Lacking careful guidelines, juries, already inflamed by a finding of oppression, fraud, or malice, are particularly susceptible to arguments about corporate wealth or malice calculated to appeal to prejudice and passion.

To ensure due process for defendants and reviewability, juries should be required to produce formal written findings, as part of a special verdict, setting forth the reasoning for the amount of punitive assessment. *See Dunlop* v. *Bachowski*, 421 U.S. 560, 571 (1975); *Morrissey* v. *Brewer*, 408 U.S. 471, 487 (1972). Such a requirement would permit courts to determine whether a jury based its assessment on improper considerations,

such as "providing enough money so that a defendant would never have to borrow from a bank again"—the basis for the jury assessment in the *Conlan* case discussed above.

CONCLUSION

As stated, this case presents a broader range of issues than *Bankers Life and Casualty Co.* v. *Crenshaw,* concerning the constitutional safeguards that should apply in cases involving punitive damages, squarely raising not only Eighth Amendment but also due process considerations under the Fourteenth Amendment. For the reasons set forth above and for the additional reasons advanced by petitioner, the petition should be granted.

Respectfully submitted,

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August 21, 1987

APPENDIX

APPENDIX A

2 California Jury Instructions, Civil, Book of Approved Jury Instructions, [BAJI] 7th ed. 1986

BAJI 14.71 (1986 Revision)

PUNITIVE DAMAGES—RECOVERY OF AND MEASURE

If you find that plaintiff suffered damage as a [proximate] [legal] result of the conduct of the defendant on which you base a finding of liability, you may then consider whether you should award punitive damages against defendant [———————— only], for the sake of example and by way of punishment. You may in your discretion award such damages, if, but only if, you find by a preponderance of the evidence that said defendant was guilty of [oppression] [fraud] [or] [malice] in the conduct on which you base your finding of liability.

["Malice" means conduct which is [intended by the defendant to cause injury to the plaintiff] [or] [carried on by the defendant with a conscious disregard for the] [rights] [or] [safety] of others.] [A person acts with conscious disregard of the rights or safety of others when [he] [she] is aware of the probable dangerous consequences of [his] [her] conduct and willfully and deliberately fails to avoid those consequences.]

["Oppression" means subjecting a person to cruel and unjust hardship in conscious disregard of that person's rights.] ["Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.]

The law provides no fixed standards as to the amount of such punitive damages, but leaves the amount to the

jury's sound discretion, exercised without passion or prejudice.

In arriving at any award of punitive damages, you are to consider the following:

(1) The reprehensibility of the conduct of the defendant,

(2) The amount of punitive damages which will have a deterrent effect on the defendant in the light of defendant's financial condition,

(3) That the punitive damages must bear a reasonable relation to the actual damages.

If you decide to award punitive damages to plaintiff against defendant, you shall state the amount of punitive damages separately in your verdict.

MOTION FILED
AUG 24 1987

No. 87-159

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE OHIO CASUALTY INSURANCE COMPANY,
Petitioner,

v.

DOWNEY SAVINGS AND LOAN ASSOCIATION,
Respondent.

On Petition for Writ of Certiorari to the Court of Appeal of California, Second Appellate District

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE, AND BRIEF OF AMICUS CURIAE, THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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MOTION FOR LEAVE TO FILE BRIEF OF AMICUS CURIAE, THE WASHINGTON LEGAL FOUNDATION

The Washington Legal Foundation hereby moves this Court pursuant to Supreme Court Rules 36.1 and 42.2(b) for leave to file the annexed Brief of Amicus Curiae in support of the Petition for Writ of Certiorari in this case. This motion is required because the respondent in this case, Downey Savings and Loan Association, has refused to give its consent for the filing of this brief. The petitioner, Ohio Casualty Insurance Company, has consented to the filing of this brief. This motion and brief is timely filed since, although the respondent filed its brief early on August 19, 1987, the time allowed for its filing

is August 24, 1987, the petition for certiorari having been received by respondent on July 24, 1987. *See* Supreme Court Rule 22.1.

INTERESTS OF AMICUS CURIAE

The Washington Legal Foundation, Inc. (WLF) is a non-profit tax-exempt corporation organized and existing under the laws of the District of Columbia for the purpose of engaging in litigation and the administrative process in matters affecting the broad public interest. WLF has more than 200,000 members, contributors and supporters throughout the United States whose interests the Foundation represents.

WLF participates in and has devoted a substantial portion of its resources to cases relating to government regulations and constitutional law. WLF has appeared as *amicus curiae* in a number of cases dealing with the constitutional rights of businesses and individuals. *See, e.g., Parklane Hosiery Co. v. Shore*, 439 U.S. 322 (1979); *Consolidated Edison Company v. Public Service Commission*, 447 U.S. 530 (1980); *Pacific Gas & Electric Company v. The Public Utilities Commission of the State of California*, 106 S. Ct. 903 (1986); *Tull v. United States*, 107 S. Ct. 1831 (1987).

In addition to these cases, WLF has been concerned with the growing abuse of the awards of punitive damages and the deleterious effect that such awards have on the economy and consumers. In that regard, WLF recently published a monograph on the subject, J. Sales, *Punitive Damages: The Doctrine of a Bygone Era* (1984) surveying the historical and current practices of the award of punitive damages.

Finally, amicus raises an additional issue not covered by the parties, *viz.*, that the prerequisites for the imposition of punitive damages were never met, although that issue is part of the due process argument.

Accordingly, amicus respectfully requests that it be permitted to file the annexed brief which we believe will assist the Court in the disposition of this case.

Respectfully submitted,

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---

BRIEF OF THE AMICUS CURIAE THE WASHINGTON LEGAL FOUNDATION

INTERESTS OF AMICUS CURIAE

The interests of amicus curiae are set forth in the foregoing motion and are incorporated herein.

STATEMENT OF THE CASE

In the interests of judicial economy, *amicus* adopts by reference the statement of the case as presented in the petition for writ of certiorari at 3-10. Nevertheless, *amicus* wishes to emphasize certain pertinent facts that may assist the Court in understanding this case.

1. In February 1973, petitioner Ohio Casualty Insurance Company ("Ohio") issued a fidelity bond to respond-

ent Downey Savings and Loan Association ("Downey") promising to *indemnify* Downey for *losses* up to $3 million incurred as a result of "any dishonest fraudulent act" of Downey's employees. *See* Opinion of Court of Appeal of California, Second Appellate District, reprinted in Appendix to Petition for Certiorari at 2a (hereinafter "Pet. for Cert.") The bond also promised to indemnify Downey for attorney's fees and court costs incurred by Downey in defending any lawsuit brought by a third party who may have suffered an economic loss because of the dishonest conduct of any of Downey's employees. *Id.* Instead of having to pay Downey's attorney's fees, the indemnity agreement contained a clause giving Ohio the *option* to defend any suit that may be filed against Downey by a person claiming a loss due to the dishonest act of Downey's employees.

2. In late 1974 and early 1975, several individuals concocted a scheme whereby certificates of deposit were to be purchased from Downey with worthless checks, and then the certificates would be used as collateral for obtaining loans from an unsuspecting third-party, American Funding Corp ("AFC"). It appears that one Downey employee was involved in this scheme, although the exact nature of his involvement was unclear at the time.

3. Before the scheme was uncovered, the individuals were able to purchase a $100,000 certificate from Downey with a worthless check and were then able to obtain a loan for that same amount from AFC by pledging the passbook reflecting the $100,000 certificate as security. American Funding subsequently called in its loan when it became due on January 8, 1976, was unable to collect from the maker, found the collateral or security to be worthless, and sued Downey in January 1976 for having wrongly assured American Funding that the $100,000 certificate was properly issued. Downey, however, had *not lost a single cent due to the scheme* since no funds of Downey's were actually embezzled or wrongly transferred. Downey was never bilked; AFC was.

4. In February, 1976, Ohio received a copy of the American Funding complaint against Downey but did not exercise its option to defend the suit, especially since Ohio believed that it may not even have to indemnify Downey at all since the conduct of Downey's employee in this scheme may not have been a dishonest act covered under the fidelity bond.[1] Regardless of the reasonableness of this belief, the fact remains that the option to defend was Ohio's, even assuming that the dishonesty of the Downey employee was clear. Accordingly, Ohio refused Downey's request that it be reimbursed for the attorney's fees heretofore incurred in defending itself against AFC's lawsuit.

5. On November 21, 1978, while the suit by AFC against Downey was still pending, Downey sued Ohio for indemnification even though Downey had *not* yet suffered any loss due to any dishonest act of its employees covered under the policy. As a separate cause of action, Downey alleged a breach by Ohio of an implied covenant of good faith and fair dealing. Downey sought compensatory damages under this tort cause of action for attorney's fees and costs incurred in *defending* the AFC lawsuit (the same amount that would be recoverable under the indemnity agreement), and punitive damages in the amount of $250,000 for Ohio's allegedly malicious manner in which it breached its duty of good faith.[2] Significantly, in its amended complaint Downey did *not* seek compensatory damages for any attorney's fees incurred in the *prosecution* of its suit against Ohio for the breach of good faith cause of action. *See* Appendix A hereto.

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[1] Indeed, 5 of the 12 jurors in the instant action believed that the Downey employee was innocent of any wrongdoing. Ohio's Opening Brief in Court of Appeal at p. 19.

[2] The amount of punitive damages was increased from $250,000 to $5 million by Downey in its Second Amended Complaint filed January 20, 1983. Attached hereto as Appendix A is the pertinent excerpt of the breach of good faith cause of action.

Rather, Downey alleged a right to recover fees and costs for prosecuting its action under its First Cause of Action for simple indemnity, which issue of damages, as will be discussed later, never went to the jury.

Although Downey had not yet suffered any loss, it sued on the grounds that Ohio had a duty *to defend* against a *potential* loss and not just a duty to *indemnify* for an *actual* loss as provided in the contract.

6. In February 1981, Downey settled the case with American Funding paying them $55,000 of the $100,000 claimed. As the court of appeal and even Downey itself recognized, Downey "did not suffer a loss [under the policy] until it paid American Funding $55,000 [in February, 1981] to settle the lawsuit. . . ." Pet. for Cert. 13a & n.1.

7. Assuming that the loss of $55,000 was due to a dishonest act covered by the policy, the extent of Ohio's liability under the policy was limited to the actual loss ($55,000) plus the attorney's fees and costs incurred by Downey to defend itself against the suit by American Funding ($68,769.75) for a total of $123,769.75.

8. On January 12, 1984, the jury awarded Downey the $123,769.75 (plus pre-judgment interest of $29,213.68) for the compensatory damages on the indemnity cause of action, and $5 million punitive damages for allegedly breaching in a malicious way a duty to act in good faith to defend Downey in the action brought by AFC, although the bond required only a duty to indemnify for actual losses. Significantly, the jury did *not* assess any compensatory damages for the breach of good faith cause of action. As will be discussed, those damages at best could include a portion of the attorney's fees Downey incurred in *prosecuting* its claims against Ohio, but not those fees previously incurred for defending the claim against it by American Funding.

9. The trial court had ruled that Downey's fees in prosecuting the action against Ohio were not recoverable and the issue never went to the jury. While the Court of Appeal reversed on this issue on February 26, 1987, the jury has yet to determine in this case the amount of any compensatory damages suffered by Downey on the bad faith claim upon which the $5 million in punitive damages was supposedly based.

In sum, the California courts in this case ruled:

(a) that the duty to indemnify henceforth includes the broader duty to defend;

(b) that Ohio breached this judge-made contractual provision of a duty to defend;

(c) that Ohio breached a judge-made implied duty sounding in tort to discharge in good faith its contractual duty to defend; and

(d) that Ohio did so not simply in an unreasonable way, but in such a way that was "malicious" justifying a record-setting award of $5 million in punitive damages.

Yet, the key undisputed facts are:

(a) the indemnity policy did not require Ohio to defend against potential losses, but only to indemnify for actual losses sustained;

(b) no actual loss covered by the policy was sustained by Downey until February, 1981 when they settled the AFC claim for $55,000;

(c) punitive damages were assessed for conduct by Ohio that occurred prior to any loss incurred by Downey and prior to any court ruling that the duty to indemnity would be judicially interpreted to include a broader duty to defend;

(d) punitive damages were awarded without the jury finding any compensatory damages suffered by Downey

for *tort* claim, *i.e.*, the breach of good faith cause of action upon which the punitive damages were supposedly to be based;

(e) the compensatory damages awarded by the jury were for the losses suffered by Downey due to the breach of contract claim; and

(f) California law expressly forbids the imposition of punitive damages for breach of contract claims. *Cal. Civ. Code* § 3294.

REASONS FOR GRANTING THE WRIT

I. THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT PROHIBITS THE PUNISHMENT OF A PERSON IN THE FORM OF ASSESSING PUNITIVE DAMAGES WHERE THERE WERE NO CLEAR STANDARDS DELINEATING THE PROSCRIBED CONDUCT.

Amicus submits that as a basic requirement of due process, no punishment can be imposed, nor a person's property deprived, without a clear standard specifying what conduct is prohibited. In this case, the defendant was severely punished to the extent of $5 million by a jury for breaching a duty to defend its insured from a potential loss even though the indemnity contract promised to pay only for an actual loss incurred.

It is well settled law that the Due Process Clause of the Fourteenth Amendment applies to corporations such as petitioner. *Grosjean v. American Press Co.*, 297 U.S. 233, 244 (1936). Accordingly, whatever due process law that is extant for individuals is equally applicable to corporations.

In addition, the Due Process Clause prohibits the deprivation of "life, liberty, or property without due process of law . . . ." While these three interests "life, liberty, or property" are textually equivalent, this Court has consistently recognized a greater or "super" due

process to be afforded in those cases involving the deprivation of "life," *i.e.*, capital punishment cases, than in deprivations of liberty or property. *Godfrey v. Georgia*, 446 U.S. 420 (1980). Accordingly, *amicus* submits that at a minmum, the due process requirements for the deprivations of property, which the assessment of punitive damages surely is, should at least be on a par with the protections afforded persons for deprivation of "liberty." This is especially so where, as here, the deprivation of "property" in the form of punitive damages is done for the purpose of punishment which to some degree limits the liberty that the person may otherwise enjoy in the use of his property. Indeed, by so "punishing" civil defendants, both their property and liberty are taken in a quasi-criminal context. As Justice Rehnquist, joined by former Chief Justice Burger and former Justice Powell stated:

> Although punitive damages are "quasi-criminal," *Huber v. Teuber*, 10 D.C. 484, 490 (1877), their imposition is unaccompanied by the types of safeguards present in criminal proceedings. This absence of safeguards is exacerbated by the fact that punitive damages are frequently based upon the caprice and prejudice of jurors. *Smith v. Wade*, 461 U.S. 30, 59 (1983) (Rehnquist, J., dissenting)

See also Rosenbloom v. Metromedia, Inc., 403 U.S. 29, 82 (1971) (Marshall, J., dissenting) (punitive damages "serve the same function as criminal penalties").

Accordingly, petitioner is absolutely correct in asserting (Pet. for Cert. at 16) that before the State can punish a person, "fair warning of what is proscribed," *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 503 (1982), must be given to avoid "arbitrary and discriminatory enforcement." *Kolender v. Lawson* 461 U.S. 352, 357 (1983). In this case, Ohio is being punished for conduct that did not at the time violate California law and was in accord with the con-

tractual agreement it had with Downey, *viz.*, to indemnify for *actual* losses, not defend against *potential* losses.

Nor does there seem to be any policy reason to extend the narrow duty to indemnify to a duty to defend. Normally, the duty to defend and to settle claims is specified as a duty in the insurance contract. The further implied duty to act in good faith to defend or settle claims brought by third-parties against the insured is to prevent the insured from being exposed to liability that may exceed the policy limits.

In the instant case, however, the maximum amount of potential loss to Downey was only $100,000, an amount well within the $3 million policy limit, even including coverage for attorney's fees and costs. Accordingly, if Downey was correct in its belief that the potential loss of $100,000 should be covered by the policy, there was no need to judicially broaden Ohio's duty to defend since no liability exceeding the policy limits was possible. Furthermore, Ohio investigated the claim for Downey's loss certainly after it was realized in February 1981. Whatever shortcomings of Ohio's investigation that occurred prior to 1981 of the inchoate claim [3] is simply irrelevant. More importantly, however, is that Ohio was not given "fair notice and warning" that it had a duty to defend as opposed to its contractual duty to indemnify. Consequently, Ohio's right to due process was violated.

In addition, there is no reasonable standard notifying persons what the range of the penalty may be. In this case, Downey was assessed a penalty of $5 million, an amount rarely imposed by courts as a fine for the most criminal of acts committed by an individual or corporation. Since a corporation cannot be imprisoned, the amount of

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[3] Although California Civil Code § 3294 permits punitive damages for "oppression, fraud, or malice" in non-contract cases, Downey alleged only "malice" on the part of Ohio in the amended complaint. *See* Appendix A hereto.

punishment meted out by criminal fine is coextensive to the amount of punishment meted out by a civil fine in the form of punitive damages. Yet the California legislature would criminally punish Ohio's behavior at best for $500 for not settling claims "in good faith." *Cal. Ins. Code* §§ 790.03 (h) (5), 790.07. In addition, insurance companies are heavily regulated industries and their license to practice can be revoked for improper insurance practices, a sanction akin to capital punishment. Since no action has been apparently taken against Ohio by the State of California in a way that was principally designed by the California legislature to regulate and punish the insurance companies for improper conduct, one must assume that the authorities of California do not view the conduct of Ohio to have been improper. Yet, a jury, acting as a mini-legislature and executive, determined in an ad hoc way that Ohio should be fined 5 million dollars, an amount that is one *million* per cent of the maximum criminal fine, and is merely a windfall to the plaintiff and its attorneys. The notion that the $500 maximum fine may not deter fails to take into account that the legislature has already made that policy decision, and that the more extreme punishment of license revocation, a form of "capital punishment," is more than sufficient to deter improper insurance practices.

II. THE AWARD OF PUNITIVE DAMAGES OF $5 MILLION WHERE NO ACTUAL DAMAGES WERE ASSESSED FOR THE TORT REPRESENTS A RATIO OF PUNITIVE TO COMPENSATORY DAMAGES OF INFINITY TO ONE IN VIOLATION OF CALIFORNIA LAW AND DUE PROCESS.

In the instant case, the jury assessed a record-setting five million dollars in punitive damages against Ohio allegedly for breaching in a malicious way the implied covenant of good faith and fair dealing, a separate cause of action sounding in tort added by Downey to its original complaint for indemnity. However, the jury did not

award any compensatory damages to Downey for the breach of that implied covenant. Accordingly, the prerequisites for the award of punitive damages was not met, and under California law and the Due Process Clause, that part of the judgment must be vacated.

The compensatory damages of $123,769.75 awarded in this case is comprised of the $55,000 which represents the settlement reached by Downey with AFC, the third-party lender, as well as attorney's fees and costs incurred by Downey in *defending* against AFC's claim for $100,000. *See* Pet. for Cert. at 8 & n.2. That amount, therefore, merely represents the compensatory damages suffered by Downey for the simple breach of *contract* claim since the indemnity contract specifically covered those items as reimbursable losses. California law expressly prohibits the assessment of punitive damages for breach of contract regardless of how malicious the breach may have been.

> *Cal. Civ. Code* § 3294 (Deering Supp. 1976) (a) In an action for the breach of an obligation *not arising from contract*, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant (emphasis added).

Although one might reasonably conclude that the breach of any implied covenant to act in good faith in discharging contractual obligations is a breach arising from the contract and therefore is not subject to punitive damages under Section 3294 of the California Civil Code, *see Egan v. Mutual of Omaha Ins. Co.*, 24 Cal. 3d 809, 819 151 Cal.Rptr. 482, 490, 620 P.2d 141, 151 (1979) (Clark, J., dissenting), the California Supreme Court has ruled that the duty to deal in good faith is an action sounding in tort. *Silberg v. California Life Insurance Co.*, 11 Cal.3d 452, 113 Cal.Rptr. 711, 521 P.2d 1103 (1974). Be that as it may, the only possible compensatory

damages suffered by Downey for the tort action, *i.e.*, the breach of good faith dealing, was the attorney's fees incurred by Downey to sue Ohio *to recover* the amounts due under the indemnity agreement, *not* the attorney's fees Downey incurred prior to that in *defending* its suit filed by the third-party lender. As for compensatory damages represented by the attorney's fees incurred by Downey in *prosecuting* its suit against Ohio for indemnity, the jury did not award Downey anything, since the trial court granted Ohio's trial motion and ruled that the attorney's fees and costs in *prosecuting* the suit was not recoverable. That *in limine* ruling was reversed and remanded by the court of appeal below (*see* Pet. for Cert. at 3a) and will be discussed later, but the fact remains that when the jury assessed a $5 million punitive damage award, it did so without awarding Downey any compensatory damages, not even nominal damages, *for the breach of good faith.* California law as well as the Due Process Clause prohibits the imposition of punitive damages when no compensatory damages are awarded, and such penalties are *per se* excessive when they approach, as they do here, a ratio of punitive damages to compensatory damages of infinity to one. *See Bundo v. Old Equity Life Ins. Co.*, 552 F.2d 1297, 1300 (9th Cir. 1981) ("California law requires that a punitive damage award bear relationship to compensatory damages . . . . Upon [absence of compensatory damages], the award for punitive damages also fails.")

Typically in an insurance case, the insured, usually an individual rather than a corporation as here, brings an action against the insurance company for failing to pay a claim that the insured believes is covered by the policy. If the jury simply finds that the loss was covered, the insurance company would of course be ordered to pay the claim for breach of contract. However, if the insured further proves that the insurer breached its duty of good faith in dealing with the insured, even in an unreason-

able way, the jury could award only compensatory damages for that tort, usually consisting of injury to feelings, emotional distress, mental anguish and the like. A mere violation of a duty of good faith and fair dealing "alone does not necessarily establish that defendant acted with the requisite [malice]." *Silberg v. California Life Ins. Co.*, 11 Cal. 3d 452, 113 Cal. Reptr. 711, 718, 521 P.2d 1103, 1110. In addition to those compensatory damages for mental distress, a jury could impose punitive damages only if they find the insurer acted not simply unreasonably, but fraudulently or maliciously in breaching its tort duty to act in good faith. Since California law prohibits the assessment of punitive damages for breach of contract claims, *Cal. Civ. Code* § 3294, the punitive damages in insurance bad faith cases would necessarily be assessed in relation to the injuries suffered by the *breach of the tort*, *i.e.*, damage to feelings, emotional distress, etc., and *not* the damages awarded for the breach of contract, *i.e.*, the amount of the original medical or automobile claim rejected by the insurer.

In the instant case, the plaintiff is not an individual but a corporation. As an artificial entity, a corporation cannot suffer emotional distress, anguish, and the like. Consequently, the only compensatory damages Downey could possibly suffer for Ohio's breach of good faith in failing to defend is what it cost Downey to get Ohio to live up to its contract, *i.e.*, certain attorney's fees and costs incurred for *prosecuting* its claim against Ohio and not for the loss of $55,000 and fees and costs incurred by Downey for *defending* itself against the AFC suit, since such costs are merely recoverable under the insurance contract as part of the covered loss, just as a medical or automobile claim may be covered in a typical policy owned by an individual.

The trial court in this case refused to allow Downey to recover any attorney's fees incurred in the prosecution of this very suit against Ohio, but was reversed by

the court of appeal below citing *Brandt v. Superior Court* (1983), 37 Cal. 31 813, 210 Cal. Rptr. 211, 693 P.2d 796. The following excerpt from the *Brandt* decision makes it clear, nevertheless, that only those attorney's fees reasonably incurred to prosecute the *contract* claim are compensable for the breach of good faith tort action:

> It is well settled that if an insurer, in discharging its contractual responsibilities, 'fails to deal *fairly and in good faith* with its insured by refusing, without proper cause, to compensate its insured for a loss covered by the policy, such conduct may give rise to a cause of action in tort for breach of an implied covenant of good faith and fair dealing.' (*Gruenberg v. Aetna Ins. Co.* (1973) 9 Cal.3d 566, 574 [108 Cal. Rptr. 480, 510 P.2d 1032], original italics.) When such a breach occurs, the insurer is 'liable for any damages which are the proximate result of that breach.' (*Neal v. Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 925 [148 Cal.Rptr. 389, 582 P.2d 980].)" (*Austero, supra*, 132 Ca.App.3d at pp. 419-420, 182 Cal.Rptr. 919 [dis. opn. of Morris, P.J.].)
>
> When an insurer's tortious conduct reasonably compels the insured to retain an attorney *to obtain the benefits due* under a policy, it follows that the insurer should be liable in a tort action for that expense. The attorney's fees are an economic loss—damages—proximately caused by the tort. (*Mustachio v. Ohio Farmers Ins. Co., supra*, 44 Cal.App.3d at p. 363, 118 Cal.Rptr. 581) (Emphasis added). These fees must be distinguished from recovery of attorney's fees *qua* attorney's fees, such as those attributable to the bringing of the bad faith action itself. What we consider here is attorney's fees that are recoverable as damages resulting from a tort in the same way that medical fees would be part of the damages in a personal injury action.

37 Cal.3d 813, 817, 210 Cal. Rptr. 211, 213, 693 P.2d 796, 798.

The *Brandt* court had stated the issue before it thusly:

> "When an insurer tortiously withholds benefits, are attorney's fees, *reasonably incurred to compel payment of the policy benefits*, recoverable as an element of the damages resulting from such *tortious* conduct? [4] We hold that they are. . . ." 210 Cal. Rptr. at 212, 693 P.2d at 797 (emphasis added).

As the quoted passage indicates, the *Brandt* court was careful to note that only those attorney's fees which were necessary to bring suit on the contract claim are recoverable as damages for the bad faith claim, as opposed to those attorney's fees incurred for that part of the lawsuit devoted to the tort claim itself, *i.e.*, the breach of good faith (as well as the legal effort that went into proving punitive damages). Clearly, if *all* of the attorney's fees and costs incurred in the suit by Downey against Ohio were allowed, then Downey would be impermissibly recouping a large amount of attorney's fees *qua* attorney's fees for that portion of its legal efforts associated with the tort action, and thus would violate the American rule on attorney's fees.

Assume, in other words, that Downey had brought two separate suits against Ohio, the first one for breach of contract or indemnity and a subsequent one for tort, *i.e.*, for breach of good faith and fair dealing. In the first contract action, Downey could only recover the amount determined to be due under the policy, *i.e.*, the loss incurred ($55,000) and fees and expenses incurred by Downey in *defending* that loss which the policy expressly stated would be covered. No attorney's fees for *prosecuting* this simple contract suit, however, would be recoverable since such an award would violate the American rule that each party bear their own attorney's fees.

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[4] The *Brandt* court in footnote 1 of its decision cautioned that it was not deciding "*when* it is reasonable to incur such fees "(emphasis in original) but merely whether reasonable fees are recoverable. *Id.*

And certainly no punitive damages would be allowed. *Cal. Civ. Code* § 3294. However, in the second subsequent lawsuit for the tort action of breach of good faith, the compensatory damages, according to *Brandt*, are only those expenses the insured incurred to obtain its payments from the insurer, *i.e.*, the attorney's fees incurred for prosecuting the original breach of contract lawsuit. However, no attorney's fees for the subsequent tort suit itself would be recoverable because then again, attorney's fees *qua* attorney's fees are not recoverable under the American rule. Any punitive damages in the tort action must necessarily be based therefore only on the amount of the compensatory damages, *i.e.*, the attorney's fees incurred to prosecute the *contract* action.

In the instant case, the two lawsuits were brought as one but the rules for determining compensatory damages for the breach of good faith remain the same as if two separate suits were brought. In this case, *no* attorney's fees for prosecuting the suit against Downey were ever assessed by the jury, and consequently no compensatory damages were awarded for the breach of good faith. Accordingly, the punitive damage award was improper as a matter of law. Even on remand, the amount of the attorney's fees that can be assessed is severely limited and does not include all of the fees incurred as a result of Downey suing Ohio. As the *Brandt* court concluded, such a sophisticated determination of determining attorney's fees as compensatory damages—fees allocable to the bringing the contract portion of the suit but awardable as damages for the tort portion cause of action—is best left to the trial judge, but if

> however, the matter is to be presented to the jury, the court should instruct along the following lines: "If you find (1) that the plaintiff is entitled to recover on his cause of action for breach of the implied covenant of good faith and fair dealing, and (2) that because of such breach it was reasonably neces-

> sary for the plaintiff to employ the services of an attorney to collect the benefits due under the policy, then and only then is the plaintiff entitled to an award for attorney's fees incurred *to obtain* the policy benefits, *which award must not include attorney's fees incurred to recover any other portion of the verdict.*" 653 P.2d at 790 (Emphasis added)

Only when the trial court in this case, or a jury if it is utilized, determines the compensatory damages for the breach of good faith, *i.e.*, the attorney's fees incurred for the contract portion of the suit, will the court or jury be in a position to determine what, if any, punitive damage should be awarded.[5] Until that happens, however, the punitive damage judgment in this case is void and must be set aside.

It only makes sense that the claim for the loss allegedly covered by the contract *not* be included as a measure for punitive damages. Assume the present facts in this case except instead of "purchasing" the $100,000 certificate from Downey, the con men purchased $1,000,000 and were able to get a loan in that amount from AFC. Why should the amount of the subsequent but covered loss be a basis upon which to inflate the punitive damages? Ohio did not cause the $1,000,000 loss in this hypothetical, one of Downey's employees did. Yet the California court, assuming that a ratio of punitive to compensatory damages of approximately 40 to 1 is reasonable, would sustain a staggering $40 million punitive damage award in that situation for precisely the same conduct Ohio undertook when only $100,000 was at stake and when presumably Downey's attorney's fees and cost would be

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[5] Not only is the amount of attorney's fees that may be awarded limited to that incurred for the part of the contract action, there is also the question, as the *Brandt* court noted, *infra* note 5, as to *when* the fees were reasonably incurred. A jury may very well conclude that a suit for indemnification filed more than two years *before* the actual loss was incurred (*i.e.*, while the suit by AFC against Downey was still pending) was unreasonable.

the same in both cases. In such a situation, an insurance company would be discouraged from carefully investigating and asserting defenses against huge claims for fear that such conduct might be construed as a breach of good faith and fair dealing resulting in the assessment of a corresponding astronomical punitive damage award. The larger the disputed claim the larger the potential punitive damages and windfall to the insured.

By being effectively forced to pay questionable larger claims, the profitability of the insurance company decreases and the inevitable premium increase results. Thus, not only do the consumers ultimately bear the burden of the assessment of punitive damages in the form of higher premiums, *see Egan v. Mutual of Omaha Insurance Co.*, 24 Cal. 3d 809, 820, 169 Cal. Rptr. 691, 702, 620 P.2d 141, 150 (1979) (Clark, J., dissenting), consumers also pay by the threat of unlimited punitive damages which discourage the defense of huge claims, the very kind of claim that one would expect prudent businessmen to more carefully scrutinize. If the lower court's decision is sustained, then the Court will in effect permit the assessment of punitive damages for amounts suffered as a breach of contract which the California legislature has expressly forbidden. *Cal. Civ. Code* § 3294.

III. THIS COURT SHOULD DETERMINE WHETHER PUNITIVE DAMAGES ARE SUBJECT TO THE EXCESSIVE FINES CLAUSE OF THE EIGHTH AMENDMENT.

In addition to the important questions of whether due process was satisfied in this case and whether punitive damages could be awarded, there is the further constitutional question of whether punitive damages, being penal in nature, are subject to the Excessive Fines Clause of the Eighth Amendment.

The penal nature of civil punitive damages has long been recognized. *See, e.g., Gertz v. Robert Welch, Inc.*,

418 U.S. 349, 353 (1974) ("punitive damages . . are private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence"); *Rosenbloom v. Metromedia*, 403, U.S. 29, 82 (1971) (Marshall, J., dissenting).

In *Trop v. Dulles*, 356 U.S. 42 (1958), this Court ruled on whether a provision of the Nationality Act revoking the citizenship of anyone court martialled for desertion was a penal law. This Court "has generally based its determination upon the purpose of the statute. If the statute imposes a disability for the purpose of punishment—that is to reprimand the wrongdoer, to deter others, etc., it has been considered penal." 356 U.S. 86 (footnote omitted). By this logic, and the clear purpose of punitive damages as authorized by most States, the similarity between the Excessive Fines Clause of the Eighth Amendment and punitive damages appears compelling.

As noted in *Ingraham v. Wright*, 430 U.S. 651, 669 n.37 (1977), "some punishments, though not labeled 'criminal' by the State, may be sufficiently analogous to criminal punishments in the circumstances in which they are administered to justify application of the Eighth Amendment."

Accordingly, just as the Supreme Court recently reaffirmed that the Seventh Amendment right to a jury trial for suits at common law is applicable to modern civil actions which did not exist in 1789, *Tull v. United States*, 105 S.Ct. 1785 (1987); *Curtis v. Loether*, 415 U.S. 189 (1974), so too should the court determine whether punitive damages are subject to the Eighth Amendment.

While amicus is aware that this Court recently noted probable jurisdiction on the Eighth Amendment issue in *Bankers Life and Casualty Co. v. Crenshaw*, No. 85-1765 (prob. juris. noted March 9, 1987), amicus submits that

the instant case is one that is in an "appropriate setting" to consider the issue as stated by former Chief Justice Burger in *Aetna Life Insurance Company v. Lavoie*, 106 S.Ct. 1580, 1589 (1986).

CONCLUSION

Because of the substantial federal questions implicated in the assessment of punitive damages in this case and others like it across the country, including whether it should have been assessed at all, the petition for writ of certiorari should be granted.

Respectfully submitted,

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Dated: August 24, 1987

APPENDIX A

(EXCERPT FROM DOWNEY'S SECOND AMENDED COMPLAINT DATED JANUARY 20, 1983)

FOURTH CAUSE OF ACTION

(For Intentional Interference With Protected Property Interest And Breach of Covenant of Good Faith And Fair Dealing)

26. Plaintiff refers to and realleges paragraphs 1 through 18, inclusive, of the First Cause of Action, and paragraphs 19 through 22, inclusive, of the Second Cause of Action, and, by this reference thereto, incorporates them herein and makes them a part hereof as if they were fully set forth at length.

27. At all times herein mentioned, Defendant OHIO occupied a special relationship to Plaintiff, its insured, and has special implied-in-law duties toward plaintiff including, but not limited to, an implied-in-law duty and covenant of good faith and fair dealing that it do nothing to deprive Plaintiff of the benefit of its Bond and that it not withhold payments thereunder without probable cause.

28. At all times subsequent to October 31, 1977, Defendants knew or should have known the truth, accuracy and veracity of Plaintiff's claim, and had ample information and facts, including the transcript of the sworn testimony of an eye witness to and co-conspirator in the alleged fraudulent scheme and conspiracy, to enable it to verify and honor Plaintiff's claim.

29. Defendant OHIO breached and violated its implied-in-law duty and covenant of good faith and fair dealing by maliciously and without probable cause failing and refusing to assume the defense of the AFC lawsuit and/or to indemnify and pay Plaintiff on account of its

losses incurred including costs, attorneys fees, and losses, and by maliciously and without probable cause failing and refusing to admit coverage under the Bond for all losses including attorneys' fees that were caused by and resulted from the dishonest and fraudulent acts of McGREW.

30. As a direct, proximate and foreseeable result of Defendant OHIO's acts and omissions to act as hereinabove alleged, Plaintiff has been damaged in the sum of $123,779.65 together with past and continuing loss of use of said sum which Plaintiff was forced to expend as a direct and proximate result of defendant OHIO's acts and omissions to act as herein alleged.

31. In doing and omitting to do the things herein alleged, Defendant OHIO acted maliciously, recklessly and with a conscious disregard of the rights of Plaintiff and Defendant OHIO's obligations to Plaintiff, and with full knowledge that these acts and omissions to act would cause Plaintiff to incur losses, expenses and attorneys' fees as aforesaid, so that Plaintiff demands exemplary and punitive damages against Defendants, and each of them. Plaintiff does not now know the amount of punitive damages necessary to adequately punish and deter Defendant OHIO, but believes that amount to be in excess of $5,000,000.00 and will seek leave to amend this Complaint at or before trial at such time as the appropriate amount of damages has been ascertained.